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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/20

3:00 p.m., February 8, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	
	G. Ercel, Temporary
	X. Blandin
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
J. E. Ismael	Jaafar A.
	L. Leonard
	G. W. K. Pickering, Temporary
A. Kafka	
	A. Lindø
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
	E. M. Ainley, Temporary
P. Pérez	
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
N. Wicks	T. A. Clark
S. Zecchini	
Zhang Z.	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

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Also Present

O. S. Eissa, Ambassador of Sudan; M. Medani, Economic Counsellor, Embassy of Sudan. D. Dunn, IBRD. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; A. I. Abdi, A. Basu, C. V. Callendar. Asian Department: W. G. L. Evers, E. Gurgen, S. Kohsaka, L. Mendras, R. J. Niebuhr, R. C. Williams. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. T. Boorman, E. H. Brau, J. A. Clement, J. P. Guzman. External Relations Department: H. O. Hartmann. Fiscal Affairs Department: D. C. McDonald, L. Mutén, O. Pettersen. IMF Institute: A. Karim, Participant. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, A. O. Liuksila. Middle Eastern Department: A. S. Shaalan, Director; P. L. Clawson, F. Drees, S. H. Hitti, M. E. Jakubiak, B. A. Karamali, S. Kawar, M. Yaqub. Secretary's Department: A. P. Bhagwat, R. S. Franklin. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Berthet, D. Gupta, T. B. C. Leddy, D. C. Ross. Advisors to Executive Directors: A. A. Agah, H. A. Arias, D. Hammann, S. M. Hassan, J.-C. Obame, T. Sirivedhin, A. Steinberg, E. M. Taha, D. C. Templeman, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, I. Angeloni, W.-R. Bengs, J. Bulloch, M. B. Chatah, J. de la Herrán, J. J. Dreizzen, C. Flamant, V. Govindarajan, N. Haque, G. D. Hodgson, Z. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, A. K. Diaby, M. Lundsager, R. Msadek, J. A. K. Munthali, K. Murakami, A. Mustafa, W. K. Parmena, M. Rasyid, J. Reddy, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, Shao Z., L. Tornetta, A. J. Tregilgas, A. H. van Ee, E. L. Walker, Wang C. Y., B. D. White.

1. INDONESIA - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/85/19, 2/8/85) their consideration of the staff report for the 1984 Article IV consultation with Indonesia (SM/85/20, 1/18/85; and Cor. 1, 2/7/85). They also had before them a report on recent economic developments in Indonesia (SM/85/25, 1/24/85; and Cor. 1, 2/27/85).

The staff representative from the Asian Department noted that Table 1 in SM/85/25 showed that the ratio of gross domestic investment to GNP had increased in 1983, even though total investment had declined by 1 percent. That result was a statistical quirk due to the large devaluation in early 1983. Nominal investment had risen by some 28 percent in 1983, reflecting in part the high import content of investments and the devaluation, while nominal GDP had risen by about 19 percent; hence, the ratio of investment to GNP had increased. Real gross fixed investment was estimated to have fallen by 1 percent in 1983. Separate data on private and public investment were not available. Total gross fixed investment had been influenced considerably in 1983 and early 1984 by the completion of a number of large projects, including one to expand liquefied natural gas output and three oil refineries. No new large projects had been started since early 1984. Excess capacity had clearly constrained private investment in some sectors, for example, textiles, chemicals, and electronics. Plywood production capacity had expanded rapidly, and no additional investment in that sector was planned. Some sectors, such as automobiles, were being promoted by the Government and would probably continue to expand, even though they too had excess capacity.

High real interest rates would affect investment in the coming period, the staff representative commented. Many of the current projects had been financed before the sharp increase in interest rates and had benefited from subsidized credit. The full impact of the high real interest rates on investment probably had not yet been felt.

It was difficult to assess the level and pattern of investment over the period of the Five-Year Development Plan because the Plan did not provide a breakdown of the data between public and private sector investment, the staff representative explained; there was only a breakdown between central government investment and all others, which lumped public sector enterprises in with the private sector. Nor did the Plan describe a pattern of investment in coming years. However, the World Bank staff and the authorities were examining the level of development expenditure in several sectors, and much of their work was to be completed by mid-1985. The Plan seemed to overstate the volume of aggregate investment that would be consistent with the 5 percent growth rate target. Additional work was admittedly required, particularly to estimate the incremental capital/output ratio for each sector, and the World Bank staff intended to present its broad findings in that area to the June 1985 meeting of the Intergovernmental Group on Indonesia (IGGI).

The main thrust of the Development Plan was to encourage private initiative and increase the relative role of the private sector in the economy, the staff representative remarked, and particularly in manufacturing, which was projected to grow by some 10 percent a year during the plan period. Apparently the authorities assumed that some activities that had been undertaken by public corporations would be undertaken by private sector enterprises in coming years, although the authorities' approach to divestment was not rigid. Sugar refining was one of the industries in which a marked increase in private initiative and capital was expected; in that context, increased private participation in plantations was envisaged. The available data did not permit the staff to assess the relative roles of public corporations and the private sector during the plan period. However, the authorities clearly wished to improve the commercial operations of many of the public enterprises, increase their efficiency, and place them in a position to generate a larger volume of the investment funds they required. To that end, the authorities planned to ensure that public entities' pricing decisions were made autonomously, so that their goods and services would be priced appropriately.

Exchange rate policy would of course play an important role in the effort to increase competitiveness, the staff representative commented. The authorities also intended to reduce transport costs, and to improve the efficiency of "downstream" industry by increasing the efficiency of "upstream" industry.

In assessing the structure of the Plan, the authorities and the World Bank and Fund staffs gave highest priority to promoting employment, the staff representative said. The staff hoped that the bias in trade policy against labor-intensive activities would be eliminated. There was some room in agriculture to absorb additional labor despite the external constraints on Indonesia. It was also important to assess the employment implications of public sector expenditure and investment on a project-by-project basis. The World Bank staff had been working to identify projects that did not have an excessively high import content and that would make a relatively large contribution to employment.

Mr. Ismael remarked that there appeared to be no basic differences of opinion between his authorities and Executive Directors. The Finance Minister had recently stated that, as a result of the decline of $1.00 per barrel in the price of Indonesian oil, the external current account deficit estimated for 1985/86 would increase by 7 percent, the overall balance of payments surplus would decrease by 8 percent, domestic revenues would fall by 1.7 percent, total revenues would decline by 1.4 percent, and foreign exchange earnings would decline by $300 million, the equivalent of about 1.4 percent of total foreign exchange earnings from oil, gas, and non-oil exports. Nevertheless, for the time being, the authorities saw no need to amend the proposed 1985/86 budget.

The swap facility had been established to stabilize the market by providing assurance that needed foreign exchange would be available, Mr. Ismael explained. The authorities saw no great need to keep the facility, but it would be difficult to eliminate it without creating an unacceptable degree of uncertainty in the market. Hence, they intended to phase out the facility gradually. Continued improvement in the overall economic climate would create the conditions in which the authorities could leave swaps to commercial banks.

The sharp rise in the debt service ratio in 1984/85 had been due to the rise in government amortization payments and to the first repayments of the financing for the expansion of liquefied natural gas production, Mr. Ismael said. In addition, in mid-1984, the Government had contracted a commercial "stand-by" loan for $600 million in response to the possible decline in the oil price. At present, the Government had some $1.7 billion in undrawn committed commercial credits. During the current year, the authorities expected to borrow in the commercial market on a small scale, mainly to preserve Indonesia's presence in the market.

Indonesia had in effect been too successful in promoting its textile exports, Mr. Ismael remarked. As a result, Indonesia and the United States had recently had to hold quota talks for the fifth time. Textiles and plywood were considered Indonesia's best export prospects in the near term, but both products faced restrictions in their primary markets, particularly the United States and Japan. Markets in Europe were not expected to grow significantly as long as the U.S. dollar remained strong and Europe's economies remained relatively weak. Given Japan's strict quality controls, it was unlikely that Indonesia could increase its exports to Japan, with the exception of some specialty products. Australia also maintained fairly stiff import barriers. Indonesia clearly faced problems in trying to diversify and increase its exports in the present world economic situation.

The uncertainties created by the tax reforms had adversely affected private investment, which had fallen by almost 70 percent in 1984 compared with 1983, Mr. Ismael continued. The sharp decline was due partly to the rush to invest in late 1983, before new laws took effect. Many local investors had not yet fully studied the new tax reforms and, therefore, hesitated to make new investments. In addition, the fact that some potential taxpayers had been able to avoid paying any taxes in the past but would certainly be unable to continue to do so in the future had probably undermined the confidence of some potential local investors.

The authorities understood that protection was inefficient and costly; but because of the adverse consequences on employment and other social factors, the elimination of restrictions would have to be gradual, Mr. Ismael commented. As capacity utilization increased and production costs decreased, the competitiveness of domestic industries would be gradually strengthened and protection could be reduced.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the views expressed in the staff appraisal for the 1984 Article IV consultation with Indonesia. They warmly commended the Indonesian authorities for their continued strong adjustment efforts, which have yielded impressive results. The balance of payments current account deficit has narrowed considerably and, with the continuation of adjustment policies, further progress toward a sustainable level is in prospect. The domestic imbalances have been reduced, as reflected in a significant moderation of inflation. It was heartening, Directors noted, that the growth momentum was being restored, even though there was some unevenness in the growth pattern, with considerable underutilized capacity still existing in the manufacturing sector. The combination of higher growth and lower inflation reflected in part the continued strong performance of the agricultural sector, and was supported by growing liquefied natural gas exports and the competitiveness of non-oil exports. The prospects appeared good for further strengthening of the non-oil economy in the period ahead.

Executive Directors also noted that the current and prospective weakness of the world oil market posed a continuing challenge for policymakers, which required timely adjustments in fiscal and monetary policy and required that structural adjustment be pursued vigorously. They supported the high priority given in Indonesia's development plan to reducing the dependence on the oil sector and to substituting additional domestic resources for externally borrowed resources. Much had been achieved in both areas over the past two years, but sustained progress would be needed because future growth prospects depended in large part on productive investment in the non-oil sector. Directors welcomed further efforts to enhance domestic resource mobilization, including the planned implementation of the value-added tax on April 1, 1985. The considerable reduction in the petroleum subsidy was also welcomed, and several Directors noted that consideration should be given to reducing other subsidies. In addition, there was scope for closer monitoring of the activities of state enterprises to ensure their contribution to public sector resource mobilization.

Directors believed that exchange rate policy had played an important role in promoting non-oil exports, improving the external position, and, more broadly, strengthening the growth prospects of the non-oil sector. In this context, some Directors noted that the exchange rate had appreciated somewhat in the last year. They emphasized the need to check such a trend to preserve external competitiveness and to permit the non-oil economy to strengthen, consistent with the broad objectives of the development plan. Many Directors stressed the importance of promoting an active and competitive private sector, the development of which would be enhanced through appropriate tax and credit policies as well as deregulation and a more export-oriented trade regime. In this regard, a number of Directors urged Indonesia to dismantle the stifling controls on entrepreneurial activity. Moreover, a number of Directors expressed regret and concern at the tendency to tighten import restrictions. They urged the adoption of a more liberal trade policy, in conjunction with flexible exchange rate management. This would contribute to improving efficiency and competitiveness and would strengthen the underlying balance of payments. It was noted that the World Bank has endorsed the thrust of Indonesia's structural adjustment policies and has indicated that further efforts to rationalize foreign trade policy are necessary if development plan goals for non-oil exports and economic growth are to be achieved. By the same token, several Directors deplored protectionism abroad, which hampered Indonesia's non-oil exports.

Directors noted the significant increase in the external debt service ratio in 1984/85 and the prospects for a continued heavy debt burden in the next few years. While debt service is still at a manageable level, recent trends suggest the need to use considerable caution in macroeconomic policy formulation and to pay close attention to future debt developments. In this regard, several Directors commented favorably on the recent strengthening of coordination and control of new public sector external borrowing on nonconcessional terms and the decision to monitor more closely developments in private debt. A number of Directors emphasized that the pursuit of administrative reforms, the development of domestic capital markets, and improvements in tax administration would enhance the prospects for private foreign investment, which, along with domestic resource mobilization, would help to avoid a worrisome further increase in the external debt burden.

The marked improvement in the overall budget outcome in 1984/85 was commented on favorably, although it was noted by some Directors that this outcome partly reflected difficulties in implementation of development projects. Several Directors welcomed the efforts under way to remove the current bottlenecks to development project implementation. However, concern was expressed by several Directors that the 1985/86 budget showed a relatively rapid rise in recurrent expenditure, including further increases in civil servants' salaries, while the planned rise in development outlays lagged. Directors recognized the rationale for the salary increases for civil servants and teachers, but cautioned against a premature relaxation of fiscal policy. Several Directors also believed that Indonesia's tax effort should be larger and that the buoyancy of the tax system could be enhanced.

Directors welcomed the strengthening of the instruments of monetary policy. They were encouraged that rediscount facilities were being more widely used, that central bank certificates were becoming increasingly accepted, and that a new money market instrument was being developed. Directors were also encouraged by the reduction in subsidized credit allocations; and they noted that interest rate reform had led to a significant increase in the flow of financial savings through the banking system. It was expected that, as this process of resource mobilization and increased efficiency in the allocation of financial resources continued and inflation moderated further, interest rates would decline somewhat from present high levels, thereby avoiding the unwelcome effect of high rates on investment.

In sum, Directors encouraged the Indonesian authorities to continue to pursue a flexible but cautious fiscal and monetary policy in response to external and domestic economic shifts. At the same time, Directors emphasized the need for more decisive action in removing structural rigidities. Such action would not only strengthen Indonesia's medium-term balance of payments prospects and reduce Indonesia's vulnerability to external shifts in oil markets but, as important, would also lay the base for stronger domestic economic growth and absorption of a rapidly growing labor force.

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

The Executive Board then took the following decision:

Decision concluding 1984 Article XIV consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Indonesia in the light of the 1984 Article IV consultation with Indonesia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the elimination in May 1984 of multiple currency practices which had arisen from certain export taxes, and notes with satisfaction that Indonesia maintains an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 7901-(85/20), adopted
February 8, 1985

2. UGANDA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Uganda (SM/85/14, 1/14/85; and Sup. 1, 2/6/85). They also had before them a report on recent economic developments in Uganda (SM/85/23, 1/23/85; and Cor. 1, 2/7/85).

Mr. Abdallah made the following statement:

> Uganda has had arrangements with the Fund since 1981. The objective of these arrangements was to reconstruct and stabilize the shattered economy, which had been declining for a decade at the end of which it had to endure a bitter war.
>
> The first three stabilization programs recorded significant achievements in stimulating growth and in reducing internal and external imbalances. Economic growth picked up remarkably in the earlier years and, although decelerating, it was still 6 percent in real terms in fiscal year 1983/84. Positive growth was achieved in an environment of subsiding inflation, with the increase in the consumer price index falling from 27 percent in 1982/83 to 20 percent in 1983/84. The fiscal deficit, at 2.8 percent of GDP, was contained within the program target and represented an adjustment equal to 1.4 percentage points from its level in 1982/83. The current account deficit of the balance of payments narrowed to the equivalent of 1.6 percent of GDP, reflecting, in part, further restraint on imports, an 8 percent increase in exports, and a decline in the deficit on the services account. As a result of continued debt relief and a rise in long-term and short-term capital inflows, the overall balance recorded a surplus in 1983/84. Consequently, the external reserve position, in part supported by drawings from the Fund under the 1983/84 program, rose substantially to cover average imports of three months at the end of June 1984, although the situation has since deteriorated somewhat.
>
> The implementation of the 1983/84 stand-by arrangement, however, has been adversely affected by weaknesses in budgetary operations that emerged in the latter part of the fiscal year. These weaknesses have persisted, and the authorities have been discussing with the staff a possible framework of a new arrangement that could be implemented after the general elections, which are scheduled to be held sometime during 1985. It is not considered appropriate to conduct an election in an atmosphere of austerity but the authorities are determined to safeguard the gains that have already been made. Almost all the principal elements of a possible program have been identified, and close consultations are also taking place with the World Bank on structural issues that need to be tackled.

The main objective of policy continues to be the acceleration of economic growth, the maintenance of price stability, and the accumulation of growing surpluses in the balance of payments. To those ends, adequate incentives will continue to be given to the agricultural sector in order to restore production to past peak levels. Last October, minimum producer prices were raised by between 46 percent and 62 percent for the major export crops, namely coffee, tea, cotton, tobacco, and cocoa. These producer prices will be reviewed semiannually to ensure that real returns to the farmer are maintained. Furthermore, the Government will continue to make available the needed inputs, such as farm implements and improved seeds, with funds made available under the Revised Recovery Program. The existing system of crop financing will be improved to encourage farmers' unions to negotiate their credit needs directly with the banks instead of using the official marketing boards. At the same time, the financial management of these boards is being strengthened to increase efficiency in their processing and marketing operations.

In the industrial sector, the problem of low capacity utilization is essentially structural in nature and there are no easy or quick solutions. While most ex-factory prices have been liberalized with a view to restoring financial viability, many enterprises remain in unsound condition. The parastatal sector continues to be a cause for serious concern, and the authorities have undertaken to reorganize it and are working closely with the World Bank in this regard. A list of enterprises has been drawn up to establish those entities that can be returned to their original owners, closed down, transferred to the Ugandan Development Corporation, or converted into joint ventures. Under the Expropriated Properties Act enacted in February 1983, a number of these corporations have already been returned to their original owners, and it is intended to accelerate the process.

The medium-term investment strategy contained in the Revised Recovery Program 1982-84 has been extended to 1985 with the primary objective of increasing production. It seeks to rehabilitate 80 priority projects in industry and tourism (36 percent), agriculture (25 percent), and transport and communications (18 percent). The Revised Program, with total outlays estimated at $1,722 million, has already been presented to aid donors through the World Bank-sponsored Consultative Group meetings. Meanwhile, the authorities have been examining possible ways of improving the rate of project implementation.

Despite recent increases in expenditure, restraint continues to be the broad fiscal policy objective, and the 1984/85 budget places emphasis on strengthening administrative capacity with the object of closer monitoring and control of budgetary outlays. The rise in the overall deficit to the equivalent of 3.1 percent of GDP reflects the increase of both recurrent and development expenditures. Recurrent expenditures have been affected by the very steep wage increases granted last June ranging from 250 percent to 500 percent. The increases were justified on the grounds that since civil service wages and salaries had been falling in real terms for a long time, morale and productivity were low and corruption was spreading. To mitigate the impact on the wage bill, the authorities have conducted a public service census to identify the personnel who are on the payroll. Though the results of the census have not yet been released, experience elsewhere suggests that a number of "employees" will be found to be nonexistent.

On the revenue side, the Ugandan authorities have both strengthened tax administration and rationalized the tax structure. They have expressed a willingness to work with the Fund staff to effect appropriate revisions of the income tax law. Additional training and equipment will be provided to the personnel in the tax department in order to improve performance.

The objective of monetary and credit policy has been to reduce internal and external imbalances in line with restrictive demand management and flexible exchange rate policies. While considerable progress has been made under previous programs, unfortunately weaknesses began to appear in the fiscal area in the last quarter of 1983/84. In their renewed adjustment effort, the authorities have reaffirmed their intention to restrain the growth of domestic credit in order to further contain exchange rate depreciation and inflationary pressures. As regards interest rates prevailing in the financial system, there can be no dispute that they are manifestly negative. However, with consumer prices running at over 90 percent; the authorities' major concern is to bring inflation down rather than appear to endorse the present level as a permanent or continuing phenomenon.

On the external front, the aim of policy is to strengthen the balance of payments in the medium term in order to enable Uganda to meet its foreign obligations, including Fund repurchases. It is also intended to eliminate the remaining arrears as soon as possible. Thus, it is expected that external reserves will be raised to a level equivalent to 2.5 months of imports from 1.5 months at end-1984. To this end, the authorities will pursue policies that would promote export growth while containing import demand in line with the recovery program. This will be supported by a continued flexible exchange rate policy through the existing foreign exchange auctions. To ensure smooth operation of the auctions, developments in the balance of payments will be closely monitored through quarterly cash flow forecasts. As to the auctions themselves, there is a need to recognize that, while they have operated reasonably well, such systems are not without shortcomings, and some imperfections have recently been observed. Corrective measures were therefore taken that have not found favor with the staff. The authorities are aware of this and are open to ideas on this and other problems related to economic management for which lasting solutions are yet to be found.

Mr. Ainley remarked that the present consultation came at a critical time for Uganda. The authorities had made remarkable progress in recent years and had shown what could be achieved, even in the most difficult circumstances, by determined adjustment policies. But their achievements appeared to be in jeopardy. A combination of fiscal weakness and excessive monetary growth had intensified the pressures on prices and the exchange rate and had clouded the outlook for growth and the balance of payments. The main question was whether, and how, the economy could be brought back on course, so that Uganda could resume the twin processes of stabilization and recovery.

In one sense, the answer to that question was clear-cut: Uganda would have to earn sufficient foreign exchange over the medium term to buy critical imports, maintain adequate reserves, and eliminate arrears, Mr. Ainley continued. Uganda must also ensure that it could meet its sizable repurchase obligations to the Fund; meeting that requirement was essential if Uganda were to benefit from further Fund support in the coming months. To achieve those goals, however, the recent disappointing trends must be reversed. As the staff had concluded, "the authorities need to strengthen financial policies substantially, accelerate the rehabilitation of the productive sectors, sustain external adjustment, and contain inflationary pressures."

In the short run, the main priority was to halt the deterioration in the public finances, the underlying cause of the recent problems, Mr. Ainley remarked. The authorities should make every effort to reverse the rapid rise in expenditure caused by the large public sector wage increases. The recent census should be used to eliminate redundant employees from the government payroll; that effort could generate significant savings. The moves to control off-budget spending were welcome, and he hoped that all current outlays would be monitored on a monthly basis to avoid overruns and to prevent new domestic arrears.

The revenue position should be improved somewhat by the recent decision to raise petroleum prices, Mr. Ainley said, but those prices as well as public utility tariffs would have to be adjusted regularly to cover operating costs and to generate much-needed revenue. In addition, there was scope to strengthen further tax administration, and the authorities should be encouraged to implement as soon as possible the recent technical assistance mission's recommendations to revise the income tax laws and broaden the tax base. Firm policies of that nature were essential to reduce both the budget deficit and recourse to domestic bank financing to more sustainable levels. The dramatic expansion in the monetary aggregates and the sizable overhang of liquidity in the economy underscored the need to tighten significantly monetary and credit policy. Such action was vital to bring inflation--which had reached more than 90 percent--under control.

He agreed with the staff that prudent demand policies were a more effective and efficient way of stabilizing the exchange rate than imposing new exchange restrictions, Mr. Ainley commented. The authorities knew from experience that such restrictions caused distortions and could encourage the re-emergence of a parallel market. Uganda had finally established--at some cost--a unified, flexible exchange rate system, and nothing would be gained by returning to restrictions or other makeshift alternatives.

In the medium term, consistent, well-planned development policies were needed to complement the adjustment effort and to revive productive sectors, Mr. Ainley considered. In that connection, the World Bank's analysis and recommendations in Appendix II (SM/85/14) were helpful. The Fund and World Bank's close collaboration to assist Uganda was commendable.

The World Bank had noted Uganda's considerable agricultural potential, Mr. Ainley remarked. The authorities should combine their flexible and highly successful pricing policies with measures to make needed inputs available, improve the system of crop financing, and strengthen the official marketing boards. The constraints on industrial production would be more difficult to deal with. As Mr. Abdallah had stated, there were no quick or easy solutions, but it was encouraging that the World Bank was helping the authorities to devise a clear restructuring strategy that would offer the best chance for success. A similar strategy was needed to reorganize and, in some cases, privatize, the public enterprises, where there was still considerable scope for constructive reform. Given the urgent need for resources, it was also crucial to make swift and effective use of aid commitments. The authorities should make a renewed effort to improve aid coordination and to select, implement, and monitor priority projects.

He was asking a great deal of Uganda, Mr. Ainley said, but there seemed to be no realistic alternative. Uganda had shown that it could adjust effectively; and it could count on considerable international goodwill. Early corrective action should make it possible to preserve some of the earlier gains and to establish the foundation for continued international support in the future.

Mr. Pickering remarked that the Ugandan economy had been turned around in the early 1980s, after years of mismanagement and a ruinous war. The three stabilization programs that had supported the upturn had established a foundation for stable economic growth. Some of the more important achievements during the recovery period were the corrections in the exchange rate system, the strengthening of agricultural production incentives, and the improvements in the implementation of financial policies.

The staff had accurately concluded that the progress to date was fragile, Mr. Pickering commented. In addition, in most respects, the process of economic and financial recovery was still largely incomplete. In the circumstances, the authorities' most recent policy actions were unfortunate, particularly the implementation of inappropriate fiscal policies, the delays in adjusting official prices, and the interference in the exchange system.

The present financial policies must be quickly reversed and directed toward creating an attractive environment for economic growth, Mr. Pickering said. The acceleration in the year-to-year rate of inflation from 18 percent in June 1984 to 78 percent in December 1984 was a by-product of the lack of appropriate fiscal and credit policies. Reducing the rate of inflation by strengthening financial management must be given high priority.

If the authorities were to achieve their fiscal objectives, they must upgrade their administrative machinery to improve the implementation of development projects and to control and monitor fiscal developments, Mr. Pickering continued. Emphasis should be placed on collecting complete data on public sector employment and domestic arrears. By permitting recurrent slippages in administration, the authorities weakened their adjustment effort and ran the risk of discouraging external assistance. The Fund should continue providing technical assistance; he hoped that the guidelines for such assistance were being interpreted in a flexible manner.

The authorities should build upon the recent improvements in the external position and strengthen their commitment to a flexible exchange rate system, Mr. Pickering considered. The unification of the exchange rate in June 1984 had undoubtedly reduced distortions in resource allocation and improved export incentives. Nevertheless, the present foreign exchange auction system was burdened by numerous restrictions on participation; despite the restrictions, the movement of the exchange rate had occasionally been volatile. The authorities' concern about the sharp decline in the exchange rate in recent months was understandable and was reflected in November 1984 in additional regulations and restrictions on participation in the auction system. Unfortunately, the auctions could undermine the progress that had been made over the previous several years in the external area. For example, there had been a sharp decrease in the average sales of foreign exchange in November 1984, compared with October. Rather than further regulating exchange sales, the authorities should seek to stabilize the exchange rate by reversing the expansionary financial policies.

The staff had raised the question of the appropriate response by the international community to the sharp deterioration in Uganda's economic performance, Mr. Pickering remarked. In his view, the Fund alone could not hope to solve Uganda's sizable problems. The authorities would need generous multilateral and bilateral support to undertake the needed structural reforms. The Fund had a role to play in assisting a country, at its request, to set economic objectives that were consistent with the desires of donors to see their resources used as effectively as possible. The kind of role the Fund had played in the early 1980s should be continued, but it should be based upon moves by the Ugandan authorities in a number of policy areas to re-establish sound and realistic economic objectives.

Mr. Clark recalled that just a few years previously the economy had been in a desperate plight. In 1981, the authorities had started a major adjustment program involving large changes in the structure of prices and supported by restrictive financial policies. By early 1984, the efforts had resulted in a decline in the rate of inflation, a resumption of GDP growth, and a considerable improvement in the external position. Against that background, the fact that the stand-by arrangement had been thrown seriously off track was particularly disappointing. It was true that the authorities faced sizable problems, particularly in tackling the massive real erosion of civil service salaries, but the deterioration in financial conditions in the second half of 1984 threatened to undermine the achievements of the previous three years. That possibility was particularly worrying because, despite the progress that had been made, the authorities still had a long way to go in revitalizing the real economy, and because the medium-term balance of payments outlook remained precarious.

Given the problems facing the economy, the broad agreement between the staff and the authorities on the measures needed to improve the situation was reassuring, Mr. Clark said. He agreed with the staff that the authorities should be urged to renew their commitment to a flexible exchange rate policy, appropriate pricing and interest rate policies, and adequately restrained financial policies.

In the circumstances, priority must be given to restoring financial and external stability and, to that end, he hoped that it would be possible before long to approve a new stand-by arrangement for Uganda, Mr. Clark continued. Resuming a formal relationship with the Fund would constitute an important signal to other creditors, whose continued support would be necessary to fill the projected external financing gaps. However, the size of the next stand-by arrangement was bound to be constrained by Uganda's relatively sizable outstanding use of Fund resources. Cumulative access had already reached the equivalent of 285 percent of quota, excluding compensatory financing, and about 325 percent when the special facilities were included. Moreover, repayments to the Fund were projected to account for more than half of Uganda's total debt service during the coming three years.

The most pressing problem clearly was the fiscal deterioration, Mr. Clark remarked. The outturn for public expenditure in 1983/84 was disappointing, and the initial projections for the current financial year indicated that substantial overruns were likely. A substantial reduction in the fiscal deficit was needed to contain both inflationary pressures and any further depreciation of the exchange rate, and it was important to bear in mind that recurrent expenditure seemed to be growing at the expense of expenditure on development. The authorities' plans to control extrabudgetary expenditure were welcome, but experience suggested that they would have difficulty in doing so, and he hoped that, with the staff's assistance, the authorities could fill the large gaps in their expenditure control procedures. It would also be important for the authorities to contain public sector employment costs. They should be able to do so in ways that were consistent with their efforts to increase the efficiency of the public service administration. To that end, the suggestions on page 23 of the staff report were helpful.

While a tighter fiscal policy was the key to handling the problems facing the economy, any deficit that persisted must not be monetized, thereby adding to the inflationary pressures and further depreciating the exchange rate, Mr. Clark said. Further increases in domestic interest rates--which were still negative in real terms--would do more to improve credit control than the introduction of administrative measures. The regulations concerning the exchange rate auctions introduced in late 1984 could cause a resurgence of parallel market activity which, in turn, could have serious adverse consequences for government revenue.

The main long-term policy goal must continue to be the rehabilitation of the real economy, Mr. Clark considered. In that context, continued close collaboration with the World Bank was clearly needed, and the full account of Uganda's relations with the World Bank Group in Appendix II of the staff report was helpful. In addition, the limited actual use of pledged aid was worrying, especially as the shortfall seemed particularly pronounced in such fundamental areas as transport and housing. The authorities were considering reformulating their long-term development priorities. That effort seemed sensible, and in making it the authorities should give priority to rebuilding the infrastructure before embarking on more ambitious projects.

Uganda had considerable agriculture potential, Mr. Clark observed, and the authorities' implementation of real increases in producer prices had boosted agricultural output. However, the "cash" agricultural sector was dominated by a single crop--coffee--and was vulnerable to swings in the price of that commodity. He wondered what plans there were for diversification into other cash crops, particularly cotton, tea, and tobacco. Finally, he broadly agreed with the staff appraisal and accepted the proposed decision.

Mr. Grosche remarked that, after several years of substantial progress, the adjustment momentum had virtually stalled because of serious slippages in financial policies. Moreover, new exchange restrictions had been introduced, producer price increases had been insufficient, and new arrears had accumulated. As a result, the current adjustment program had become inoperative. In addition, the agricultural sector continued to suffer from inefficient production, financing, and distribution techniques, and industry was still operating at low levels of capacity. The latest available information suggested that financial policies had become even more expansionary, the Government's recourse to domestic bank financing had increased substantially--leaving virtually no room for private sector credit--and the rate of inflation had accelerated quickly while revenue had fallen far short of the necessary volume. At the same time, however, developments in the external accounts had been fairly satisfactory, although he agreed with the Fund and World Bank staffs that those developments were due mainly to nonrecurrent factors and did not constitute the beginning of a positive longer-term trend.

He wondered why the authorities had turned away from the Fund-supported program, which had begun to produce promising results, particularly an increase in output and a decline in the rate of inflation, Mr. Grosche said. The staff had suggested that the program might have been abandoned because of internal security problems and pressures on the budget, particularly the demand for higher public sector salaries. It was true that the loss of real income by civil servants had made it even more difficult for the authorities to attract skilled persons, but he fully agreed with the staff that the authorities should take a number of steps to minimize the deterioration in fiscal performance.

In its appraisal the staff had asked how the international community, including the Fund, should act to encourage Uganda to return to its earlier adjustment efforts, Mr. Grosche noted. For the time being, it would be best for the Fund to continue to provide advice. Uganda was already benefiting from Fund and World Bank technical assistance in a number of areas. The advice and technical assistance should clearly show the authorities the consequences of optional adjustment strategies. Room for additional Fund financial assistance seemed virtually nonexistent in view of Uganda's outstanding use of Fund resources and mixed track record. The deterioration in Uganda's economic situation was due mainly to the authorities' policies and not to exogenous shocks. Hence, the authorities themselves must tackle the serious economic situation and resume their adjustment effort. Only after Uganda had made the first step to help itself could it appropriately ask the international community for assistance.

The staff had clearly specified the areas where firm action was required, Mr. Grosche commented. Highest priority should be given to the introduction of corrective fiscal measures, including steps to reduce the wage bill. The review of the civil service should be carried out with determination, the pay-as-you-earn income tax for civil servants should be restored forthwith, and control of the budgetary process should be strengthened. The strongly negative real interest rates were inconsistent with the adjustment requirements and should be raised; they encouraged capital flight and discouraged domestic savings and efficient resource use. The authorities should also take appropriate steps to stimulate agricultural and industrial activity and, in that connection, the World Bank had made useful recommendations. The desired thorough rehabilitation of production could only be achieved in conjunction with much more prudent financial policies. The external position had improved, but it would eventually be adversely affected by the very loose financial policy stance. The authorities should eliminate the restrictions on the auction system for foreign exchange and restore the system that had been in place prior to November 1984. The sizable repurchase obligations to the Fund also underscored the need to strengthen the external accounts. Finally, the proposed decision was acceptable.

Mr. Polak stated that he agreed with the staff appraisal. The proposed decision should be approved.

Uganda's economic and financial situation was worrying, Mr. Polak said. The serious deterioration in economic policy performance since mid-1984 was particularly regrettable because Uganda had successfully implemented economic adjustment programs during the two preceding fiscal years. The main cause of the deterioration was the relaxation of financial policies, which had led to an increase in the rate of inflation and to the depreciation of the exchange rate.

The authorities had been able to come close to the program target for the overall fiscal deficit in 1983/84, although owing mainly to luck rather than sound policy performance, Mr. Polak commented. Development outlays had been well below target, while recurrent outlays, including security expenditure and unclassified outlays, had considerably exceeded the program targets. As Uganda was still in the process of reconstructing and rehabilitating the economy, the slow implementation of development projects was particularly worrying. The considerable deterioration in the fiscal situation in the first quarter of 1984/85 had been due mainly to the massive increase in wages and salaries of various categories of civil servants. The erosion of real wages during the previous several years had warranted a considerable adjustment, but the actual increases had been much larger than Uganda could afford and had caused severe shocks to the fragile economy. Wages in the parastatal and private sectors had risen less rapidly, owing partly to delays attributable to the financial problems of the enterprises concerned; in the parastatal sector, costs apparently were rising more quickly than the prices charged by enterprises. The census should help the authorities to improve their control over the public sector wage bill, although the coming elections might delay the needed reductions in civil service staff. The overruns in the other expenditure categories apparently were due to inadequate control procedures.

The overall fiscal deficit greatly exceeded the target and had been covered by domestic bank financing, Mr. Polak noted. As a result, monetary policy had become even looser than hitherto. Real interest rates were markedly negative, and he agreed with the staff that they should be rapidly increased in line with the rate of inflation, even if, as the authorities hoped, the present high rate of inflation was merely temporary.

The medium-term projections included gradually increasing external current account deficits through the 1980s and declining surpluses in the overall external balance, Mr. Polak remarked. Moreover, the surpluses would be insufficient to cover fully Uganda's relatively large repurchases to the Fund, which, together with the planned elimination of arrears and buildup of official reserves, would create financing gaps in 1985 and 1986. According to the medium-term projections, the authorities apparently wished to strengthen the reserve position and permit imports to increase considerably. He wondered whether those objectives were realistic; in any event, they would certainly be out of reach if the present expansionary financial policies were maintained, thereby encouraging a further depreciation of the Uganda shilling.

On page 11 of the staff report it was stated that the authorities broadly agreed with the staff on the need for "as much restraint as possible in the area of financial policies," Mr. Polak noted. He wondered whether that statement was meant to imply that some groups in Uganda were unwilling to accept the consequences of a persistent adjustment effort. Apparently that unwillingness was the reason for the delays in concluding the census of government personnel, particularly the armed forces.

The Fund alone was clearly unable to help the authorities to handle all the problems facing Uganda's economy, Mr. Polak said. Aid donors and the World Bank would have to play a major role in restoring productive capacity. The Fund should continue to play an important role within the quantitative limits imposed by the policies on access to its resources. Any arrangement with the Fund would have to heavily emphasize budgetary restraint to ensure that recurrent expenditure would be kept under control. It might well be difficult for the Fund to judge what salary increases were appropriate or how many persons were on the government payroll, but the Fund could encourage the authorities to keep nominal outlays to levels that could be afforded without intensifying inflationary pressures. Accordingly, any future stand-by arrangement should provide for frequent reviews.

In 1984, as in 1983, Uganda had made no progress in improving its relations with one of its bilateral creditors, Israel, Mr. Polak remarked. Uganda still had not concluded a bilateral agreement with Israel as required under the Paris Club provisions of end-1982. As a result, Paris Club debt relief for Uganda in fiscal years 1983/84 and, presumably, 1984/85, had been blocked. The absence of a bilateral agreement could have consequences for Uganda's access to Fund resources. In summing up the discussion on the settlement of disputes between member countries at EBM/84/99 (6/22/84), the Chairman had stated that:

> Directors also generally agreed that, if an anticipated bilateral agreement required by the Paris Club, between a debtor and one of its official creditors, were not ratified within the specified period, the amount of arrears involved should be included in the calculation of arrears for purposes of the debtor country's Fund-supported program. While there was general support for that approach, there was a call for flexibility and the exercise of judgment by the Fund when making such decisions during the course of a Fund-supported program. If a debtor country had made its best efforts to comply with a Paris Club requirement to conclude a bilateral agreement but had been unable to do so, the arrears involved should not be included in

the calculation of arrears for purposes of the debtor country's Fund-supported program. However, such judgments should be made on a case-by-case basis.

It could not be strongly argued that Uganda had made its best effort to reach a bilateral agreement with all its creditors.

Mr. Dallara said that economic developments in Uganda during the previous year were particularly worrying because they might reverse the gains made under the comprehensive adjustment program adopted in 1981. While the authorities had maintained some of the policy measures that were part of the previous stand-by arrangement--including the foreign exchange auction and the periodic adjustment of administered prices--they had permitted large deviations in other areas, particularly fiscal and monetary policies. As a result, the rate of domestic inflation had accelerated dramatically and the Uganda shilling had depreciated rapidly. Moreover, the rapid expansion of domestic demand had led public enterprises to borrow abroad on commercial terms and at short-term maturities to repay loans extended by the Central Government. Such stopgap measures would inevitably create a debt-servicing burden that Uganda could ill afford.

The fiscal deterioration apparently was at the heart of the problems facing the economy, Mr. Dallara continued. The internal security situation had undoubtedly caused an increase in expenditures. Moreover, some adjustment in wages had been necessary as there had been no increase in civil service wages for ten years. He wondered whether the authorities had completed the census of the civil service or made any effort to reduce the number of persons on the civil service rolls. If the number had been reduced prior to the wage increase, the rise in personnel expenditures would have been smaller. It would be even more difficult to reduce government employment in the coming period, but the authorities would have to do so if the budget deficit were to return to a sustainable level. Furthermore, additional strong steps would be needed to control the cash deficit, which was expected to be more than twice as large as originally budgeted. The authorities' intention to avoid extrabudgetary expenditures should help to contain the growth in domestic arrears.

Containing the budget deficit would enable the authorities to exercise the needed restraint in credit and monetary expansion and to reduce the rate of inflation, which had reached approximately 90 percent, Mr. Dallara went on. Interest rates would have to be increased to control aggregate demand and to support the exchange rate policy until the rate of inflation was reduced and confidence in the Uganda shilling was restored.

The authorities had maintained the foreign exchange auction system and had added some new exchange restrictions, Mr. Dallara noted. The authorities should be discouraged from using administrative controls, as they hindered the efficient allocation of foreign exchange; stringent demand management was a more effective way to affect the demand for foreign exchange.

The authorities had maintained a system of producer price adjustments for export crops in order to maintain incentives for producers, Mr. Dallara remarked. They did not control producer prices of food crops. Crop financing mechanisms apparently were being improved, but adequate credit must be made available; to that end, central government recourse to credit must be restrained.

Recent developments in the public enterprise sector, particularly the planned divestment of a number of entities, were welcome, Mr. Dallara said. The World Bank apparently had been very helpful in formulating the reform measures. The authorities' efforts to address the claims of former owners of expropriated properties were also welcome; they should help to restore confidence in Uganda.

As he understood it, the authorities were interested in a new Fund-supported program, which would, however, make Uganda a prolonged user of Fund resources, Mr. Dallara commented. The Fund could continue to play an important role in Uganda's adjustment efforts, but a new program was not necessarily the best framework within which to do so. The projected overall balance of payments surpluses in the medium term seemed to indicate that Uganda would be able to make repurchases, but the debt service projections suggested that, if borrowing from the Fund were to continue, the debt service burden would probably remain the equivalent of some 30 percent of exports of goods and services. Uganda's income was very low, and priority should therefore be given to securing long-term development assistance, rather than short-term and medium-term balance of payments financing. Recent experience suggested that, once a country became a prolonged user of Fund resources, it was increasingly difficult for the Fund and the country to find a mutually acceptable approach to adjustment consistent with the needs and objectives of both the Fund and the member country.

The continued exchange restrictions in the form of arrears were a cause for concern, Mr. Dallara stated. The Fund's policy regarding exchange restrictions was to approve them only if they were temporary and if an economic adjustment program was in place, thereby ensuring that the restrictions would indeed be temporary. Finally, the proposed decision was acceptable.

Mr. Alfidja remarked that since mid-1981 the authorities had shown a strong determination to reconstruct the economy. They had successfully implemented two consecutive Fund-supported programs, the World Bank had supported their medium-term recovery and rehabilitation program, and Uganda had obtained additional financial assistance from other international multilateral and bilateral sources.

The third Fund-supported program, approved in September 1983, was to have consolidated the considerable and commendable progress in expanding real output, reducing the high rate of inflation, and containing the internal and external imbalances, Mr. Alfidja commented. The interruption of the program was regrettable, and the authorities should be urged to intensify their adjustment efforts in the coming period.

The relatively high producer prices for export crops maintained by the authorities had had a positive affect on the export sector as well as on the budget, Mr. Alfidja observed. Producer prices for food crops had been freed from controls, but agricultural production had remained well below the considerable potential and the peak levels of the early 1970s, and he was pleased that the authorities intended to maintain their commitment to provide adequate incentives to farmers to increase production. Their intention also to accelerate the utilization of aid commitments and project implementation, improve the system of crop financing to meet the credit needs of farmers' cooperatives, and restructure the marketing boards was welcome. The efforts the authorities were making, with World Bank assistance, to rehabilitate the industrial enterprise sector should go a long way toward reversing the declining rate of capacity utilization.

Financial policies and performance had deteriorated markedly in recent months, Mr. Alfidja noted. The improvement in overall government finances during the preceding two fiscal years had been eroded somewhat by the recent expansionary fiscal policies. He was pleased that, following the generous increase in wages and salaries to civil servants after the long wage freeze, the authorities planned to contain the budgetary wage bill by eliminating redundant employees and reducing nonwage allowances and fringe benefits. The public employment census was a step in the right direction, and priority should be given to implementing recommendations implied by the census results and to instituting a system to monitor expenditures on a monthly basis.

The increase in the retail prices of petroleum products, which had eliminated the relevant subsidy and was making a moderate contribution to budget revenues, was welcome, Mr. Alfidja said. The measures introduced in mid-1984 to improve tax administration and to rationalize the tax structure should be strengthened.

Monetary and credit policies should be tightened to support the fiscal measures, Mr. Alfidja continued. The rapid growth in credit expansion--particularly credit to the Government, which during the first five months of 1984/85 was more than three times the amount planned for the whole fiscal year--should be firmly restrained. Such action was particularly important because of the inflationary pressures that had apparently emerged and their adverse effect on the exchange rate.

The flexible exchange rate policy had greatly enhanced the role of relative domestic price adjustments in stimulating production and in encouraging efficient resource allocation, Mr. Alfidja commented. The policy should be maintained, and the bottlenecks in the foreign exchange auction system should be eliminated.

The authorities understood the weaknesses in recent policy formulation and implementation and were taking steps to strengthen the relevant policies and procedures, Mr. Alfidja remarked. The support of the international community through continued debt relief and a rise in capital inflows had helped Uganda to record an overall balance of payments surplus in 1983/84. Moreover, Uganda's record of cooperation with the Fund and the World Bank was good. The international community in general, and the Fund in particular, must not abandon Uganda at the present critical stage in its recovery effort. The international community should maintain its commitment to provide the needed financial and technical assistance. The proposed decision should be approved.

Mr. Vasudevan said that he generally agreed with the staff appraisal. The authorities had been unable to implement fully the 1983/84 program because of their expansionary fiscal policy, the new restrictions on the exchange system, and the delays in adjusting official prices. In 1984/85, there had been deterioration in both the fiscal and monetary areas, as reflected in the intensification of inflationary pressures and the decline in official reserves. Significant revenue measures had been implemented in both 1983/84 and 1984/85, and the main reason for the serious budget imbalance in 1984/85 was the substantial salary adjustments. However, the authorities had had no choice but to make the adjustment; salaries had been kept at extraordinarily low levels for a long period and despite high rates of inflation. Moreover, given the security conditions in Uganda, the rising trend in expenditure was not surprising. He wondered whether the underlying demand on budgetary resources had been taken into account in the design of the three Fund-supported programs, and whether an extended arrangement, rather than a series of one-year stand-by arrangements, would not have been more appropriate.

He sympathized with the authorities, who wished to maintain a mechanism for allocating foreign exchange to ensure that priority sectors received adequate amounts, Mr. Vasudevan commented. Such a mechanism could perhaps be appropriately used as a short-term measure to help prevent undue deterioration in the external position while thorough tax and tariff reforms were being considered. The need for the allocation mechanism should be assessed in the light of the recent further deterioration in reserves and of the need to ensure that Uganda would become current in its external payments.

Uganda's growth performance during the previous three years had been remarkable, and the authorities should maintain the growth momentum for several years along with appropriate adjustment policies to achieve external and domestic balance and to ease the debt service burden, Mr. Vasudevan remarked. Their experience in implementing the recovery program during the previous three years should help them in their effort to reformulate their long-term development initiatives in the coming period. The general thrust of the development strategy under the existing recovery program was appropriate. There had obviously been some implementation problems, which were being analyzed by the authorities. He agreed with the staff's suggestions on page 24 of the report to achieve a more rapid and broad-based expansion of production.

In summing up the previous Article IV consultation discussion, the Chairman had stated that the "outstanding record of cooperation between Uganda and the Fund as well as with the Bank would continue in the years ahead," Mr. Vasudevan noted. Given the authorities' commendable cooperation and the painful policies they had implemented under Fund-supported programs, the Fund should stand ready to assist Uganda through a well-designed extended arrangement. In addition, the Fund should use its good offices in obtaining the external financing from the World Bank and bilateral donors needed to enable the authorities to implement successfully the Revised Recovery Program aimed at achieving viable medium-term internal and external positions.

The staff representative from the African Department remarked that one of the important issues in Uganda was the scope for diversification, particularly in cotton, tea, and cocoa. Table 3 in SM/85/23 suggested that there was room to increase the volume of the principal agricultural crops if the right financial and planting conditions existed. Coffee output had reached peak production in 1983/84, but cotton, tobacco, and tea had reached just 18 percent, 36 percent, and 16 percent, respectively, of their peak production. Several projects had been started in 1982-83 to increase output of tea, cotton, and tobacco. For example, tea processing and cotton ginning capacity were being rehabilitated in collaboration with foreign companies, and U.S. and U.K. companies were involved in the tobacco sector. The staff hoped that those efforts would make significant progress in moving output toward peak levels in the future. In addition, better financial management of the relevant parastatals was needed. The World Bank could help by preparing sectoral studies and by making concrete proposals.

Wage increases had been a problem in the recent past, the staff representative noted. The authorities had been attempting to correct the loss in income in the 1970s and early 1980s. Wage increases of 20 percent in August 1981 and of 50 percent in April 1983 had been granted, and in June 1982 the pay-as-you-earn tax rate had been reduced to zero for civil servants. As a result, real incomes had been growing by 6-7 percent a year.

The staff had not recommended an extended arrangement for Uganda because of the inadequate data base and the inability to establish clear policy guidelines and objectives for a period as long as three years, the staff representative said. The staff was following developments in Uganda closely, and a series of stand-by arrangements provided greater flexibility to address problems as they arose and to make needed changes in the adjustment effort during each one-year program period.

A coherent financial program supported by the Fund, banks, and donors would make a significant contribution to continuing the recovery, raising output, and halting the slide in the financial markets, the staff representative considered. It was important for the Fund to show its strong support for the authorities' efforts to introduce appropriate adjustment policies. The staff would certainly not wish to see the Fund withdraw all support from Uganda in the coming period.

As the staff understood it, the authorities had prepared a statement containing their questions and doubts about Israel's financial claims, the staff representative said. The doubts were essentially legal in nature and concerned, for instance, whether the debt was in shillings or dollars, the size of the debt, and the existence of appropriate documents. The statement had been transmitted to the Israeli authorities through Uganda's agent in London. At the same time, the Ugandan authorities had made counterclaims for sizable debts owed by Israel, including those resulting from damage caused during the raid of the Entebbe Airport. The claims issue was essentially a political one. The staff had attempted to obtain as much factual information as possible and was hopeful that the issue could be resolved in the coming period. The staff considered that it was not in a position to do more than collect the relevant facts and make them known to both parties. Once an agreement had been reached, Paris Club rescheduling of $15-25 million in debt should be possible. Rescheduling was not a certainty and had not been reflected in the estimated financing required to support the past adjustment program.

In assessing possible action to reduce the wage bill, it was important to appreciate that, while some important economic activities could be closely monitored, others could not, the staff representative went on. The authorities had conducted a public service employment census in October and November 1984. Some ministries had participated in the census in a systematic way, but others had not. It had proved difficult to involve all the members of the defense and security forces--particularly those in the countryside--in the exercise. While the authorities might eventually arrive at a figure for total employment, they probably would not be able to disaggregate the data by individual ministries. Similarly, while the authorities might be able to calculate the total wage bill in nominal terms for all ministries, it would be difficult for them to obtain accurate data on the number of, and wage bill for, temporary employees. Hence, the authorities might not be able to establish employment ceilings and nominal wage targets on a ministry-by-ministry basis in the near future.

The Fund had been able to support three adjustment programs for Uganda even in the absence of detailed employment and wage data, although the slippages in those areas in the past had not been as great as the current slippages, the staff representative from the African Department pointed out. While detailed monitoring would not be possible in the coming period, the authorities could be encouraged in their efforts to bring discipline and order to public sector employment and wages by aiming to achieve basic targets. During the latest mission, the staff had suggested to the authorities clear guidelines on how such a monitoring process could technically be implemented; the first urgent task of the Fund's Fiscal Affairs Department fiscal expert advising on the budget was to establish a monitoring process that would become progressively detailed in its coverage. The World Bank had provided two additional technical assistants to improve the monitoring of public finances and a third technical assistant to improve the monitoring of development expenditures in particular. In sum, the staff was urging the authorities to act as quickly as possible to make progress in monitoring key areas.

The Deputy Director of the Exchange and Trade Relations Department remarked that, in assessing the possibility of an extended arrangement for Uganda, it was important to bear in mind that, because of the substantial changes in relative prices in Uganda over the previous several years it had been very difficult for the staff to set performance targets covering a period more than two quarters in the future. In addition, in June 1981, Uganda's economy had still been devastated and the authorities clearly had not been in a position to undertake the kinds of structural adjustment policies typical of an extended arrangement.

Despite the absence of a Fund-supported program, the authorities planned to make further reductions in arrears in 1985, the Deputy Director of the Exchange and Trade Relations Department noted. As the staff representative from the African Department had noted, the payments to Israel were in dispute. There had been difficult and delicate discussions on the matter. As to the attitude of the Paris Club with respect to the bilateral arrangement, the Club might well take up the matter when the Ugandan authorities presented any new request for rescheduling.

Mr. Abdallah remarked that there had been claims and counterclaims involving Israel and Uganda. Both parties to the dispute were in the process of preparing for discussions in the near future; the procedural arrangements for the talks had been accepted by both parties and the World Bank. Some of the claims had been submitted to arbitration in Sweden. The Ugandan authorities fully understood that it was not in their best interest to appear to be taking no action on the claims. Accordingly, more rapid progress in settling the claims was likely in coming months.

The authorities regretted the slippages in policy implementation since mid-1984 and were determined to bring their adjustment efforts back on track, Mr. Abdallah said. Because of the security situation, the army's role was somewhat larger than in most other countries, and the civilian authorities had some difficulty in fully applying policy measures throughout the country. However, progress in that area was clearly being made. The census of civil servants had been completed, and the Cabinet was examining the findings, which were to be announced in the coming weeks and should result in some reductions in the wage bill.

The next staff mission to Uganda should be able to gain a better understanding of the various policy options available to the Government, Mr. Abdallah considered. The authorities clearly did not hold dogmatic positions on economic policy matters. The previous mission had been in Uganda at a particularly difficult juncture: there had been large salary increases which had affected liquidity.

The Fund had an important role to play in Uganda in the coming period, Mr. Abdallah stated. The improvements in the economy in recent years had been due partly to the Fund's support, and he was confident that further progress could be made. The slippages in recent months were not serious. In addition, Uganda still had considerable potential, partly because of its favorable climate and soil. The sugar and tea plantations could be rehabilitated, and output of those crops could certainly be increased. There was a sizable market for them, and the plantations had not suffered from the drought that had struck other parts of East Africa. Uganda had grown maize for commercial purposes for the first time in 1984 and had already been able to produce and sell 70,000 tons. Having recognized the potential for maize, the authorities could probably considerably increase output in 1985. Continued increases in rural incomes should encourage people to move back to the countryside and to work the land.

The Fund had sometimes been criticized by other African countries for its role in their adjustment efforts, and it should make a clear and firm effort to support the adjustment process in Uganda, Mr. Abdallah said. The authorities were grateful for the strong financial and technical support they had received from the international community, and they were determined to demonstrate their ability to help themselves. There was every reason to feel confident that further progress would be made in the coming period. Uganda had already used a fairly substantial volume of Fund resources, and, as a result, would not be able to count on as much financial assistance in the coming period.

Mr. Dallara remarked that, as Mr. Abdallah had implied, when a member country limited its use of Fund resources in the early stages of its adjustment effort, it allowed room for additional assistance at later stages.

The Acting Chairman made the following summing up:

Executive Directors generally endorsed the staff appraisal following the remarkable progress in the adjustment effort that had been undertaken in recent years. However, they expressed deep concern about the sharp deterioration in policy performance over the past year. In particular, they noted that fiscal performance, which had already deteriorated in 1983/84, leading to unprogrammed short-term foreign borrowing and the accumulation of new domestic arrears, had weakened even more markedly since the beginning of the current 1984/85 fiscal year. They observed that the deterioration in the government finances was largely attributable to the increase in wages, the inadequate adjustments in officially administered prices and tariffs, and serious weaknesses in the control and monitoring of government expenditures.

Directors noted that the recent slippages in financial policies had contributed to a marked acceleration in the growth of broad money and a sharp increase in the domestic inflation rate, leading to a further depreciation of the exchange rate. Moreover, Directors observed that the process of economic recovery and external adjustment, undertaken with Fund assistance since 1981, remained largely incomplete, and they urged the Ugandan authorities to reinvigorate the adjustment effort with the utmost urgency.

Directors, in particular, emphasized the need to improve fiscal performance, which they considered pivotal for any credible adjustment program. To that end, they recommended that the public service employment census should be completed and used to eliminate redundant employees and reduce nonwage allowances and benefits; official prices and tariffs should be adjusted sufficiently to avoid budgetary subsidies; economies should be achieved in other discretionary nonwage outlays; a system of control and monthly monitoring of government expenditures should be established on an urgent basis; and early steps should be taken to improve tax administration and introduce a rational income tax system, especially to reintroduce the pay-as-you-earn income tax for government employees. Directors felt that tight fiscal policies should be supported by adequately restrictive credit and monetary policies, including the establishment of positive real levels of domestic interest rates.

Directors strongly urged the Ugandan authorities to remove the existing restrictions on bidding at the foreign exchange auction as quickly as possible so as to discourage the growth of the parallel market for foreign exchange and contribute to the establishment of a realistic official exchange rate. Directors also considered this to be essential for preventing the emergence of distortions in prices and resource allocation. The need to eliminate external arrears, the high debt service obligations in the next few years--including repurchase obligations to the Fund--and the desirability of replenishing external reserves added to the urgency for significant and sustained adjustment.

Directors also stressed the need to achieve a more rapid and broad-based recovery of production. Together with a return to realistic pricing, exchange rate, and interest rate policies, the authorities were urged to act quickly in a number of other areas in collaboration with the World Bank. First, Directors noted the need to speed up the use of existing aid commitments and the implementation of rehabilitation projects, particularly in agriculture and industry. Second, Directors stated that the ongoing studies of parastatal enterprises should be completed expeditiously, so that appropriate decisions on direct investment or reform measures to improve their financial management and reduce their reliance on bank credit and/or government support can be taken. Finally, Directors urged the Ugandan authorities to follow a prudent policy with regard to selection of projects and their foreign financing so as to expand production and promote external adjustment without worsening the external debt service burden.

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

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Uganda's exchange measures subject to Article VIII, Section 2(a) and in concluding the 1984 Article XIV consultation with Uganda, in the light of the 1984 Article IV consultation with Uganda conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/85/14, Uganda continues to maintain exchange restrictions on payments and transfers for current international transactions, including restrictions evidenced by external payments arrears. The Fund urges Uganda to undertake the early elimination of these restrictions.

Decision No. 7902-(85/20), adopted
February 8, 1985

3. SUDAN - OVERDUE FINANCIAL OBLIGATIONS - COMPLAINT UNDER RULE K-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors gave initial consideration to the report and complaints relating to Sudan's overdue financial obligations in the General Department and the SDR Department, and to the notice of Sudan's failure to settle a financial obligation to the Trust Fund (EBS/84/262, 12/12/84; and Sup. 1, 2/6/85). They also had before them a background paper on the origins of Sudan's external payments difficulties (EBS/85/30, 2/1/85).

His Excellency, Omer Salih Eissa, Ambassador of Sudan to the United States was also present.

The Director of the Middle Eastern Department made the following statement:

> In response to the invitation from President Nimeiri, I, accompanied by another staff member, visited Khartoum during the period January 26-31. During our stay, we had a series of meetings with the Minister of Finance and the Governor of the Bank of Sudan before meeting with the President on January 30.
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> The first question that we raised with the Minister and the Governor was that of arrears to the Fund. In this regard we explained the implications for Sudan of further delay in discharging the arrears, conveyed the concerns of management and of the Board, referred to today's Board consideration of the issue, and urged that all outstanding obligations to the Fund be settled forthwith and that Sudan remain current thereafter. The Minister and the Governor reiterated their commitment to pay Sudan's obligations to the Fund as soon as possible, and indicated that attempts will be made to effect a partial payment

prior to today's Board meeting and to settle the remaining obligations soon thereafter. However, they maintained that the severe foreign exchange difficulties being faced by Sudan were partly caused by the slowdown in aid disbursements and felt that an understanding on corrective economic policies with the Fund staff could facilitate disbursement of aid that was committed in 1984.

We then discussed the package of economic policies that would help improve Sudan's balance of payments enabling it to discharge arrears to the Fund and remain current in its payments thereafter; in these deliberations, we resolved with the Minister and the Governor the differences regarding the policies that were proposed by the staff team in December 1984 and summarily reported to the Board on December 19, 1984. However, in view of the authorities' perception that the arrears question could not be fully resolved without a simultaneous resumption of aid flows, we discussed with the Governor and the Minister a scenario aimed at creating the conditions for possible movement on both fronts at the same time. Assuming that the Sudanese authorities could adopt an appropriate package of corrective policy measures, and subject to management approval and agreement of the World Bank, the staff would arrange an informal meeting of the Sudanese authorities and Sudan's major creditors to provide Sudan an opportunity to discuss its economic policies and the resumption of disbursements from the already committed aid. Throughout our deliberations I made it clear that only after Sudan became current in its financial obligations to the Fund would it be possible to discuss a stand-by arrangement. If these discussions were successful, they could pave the way for the convening at a later stage of the Consultative Group for additional foreign aid and of the Paris Club for debt relief.

The Minister and the Governor asked me to present these policies and their implications to the President. In the meeting, after urging the President for immediate clearance of arrears to the Fund and discussing the current economic situation, I outlined the proposed package of policies and their implications, particularly the price effects. The President, however, rejected the policy proposals stating that in the present circumstances the Sudanese people could not adopt measures that result in price increases. I explained, in some detail, that in the absence of appropriate corrective policies, prices are going to rise even faster reflecting continuation, and even intensification, of foreign exchange shortages and excessive money creation. The President remained unconvinced and asked that we prepare alternative proposals that did not impose additional hardships on the already hard pressed Sudanese people.

The President also regretted the lack of understanding and sympathy on the part of the Fund for Sudan's present economic predicament. Nevertheless, he instructed the Governor to discharge the financial obligations to the Fund as soon as possible.

Following the meeting, I reminded the Minister and the Governor of the President's instructions for payment to the Fund and urged them to do so. Their response was that they would have already done so if resources were available. However, they reiterated that some amount will be paid before today's meeting.

The Treasurer remarked that confirmation had been received from the Federal Reserve Bank in New York that $10 million had been paid to the Fund by Sudan on February 7 and 8, 1985. The Sudanese authorities had indicated that they wished to apply the amount fully to discharge the overdue SDR charges earlier reported as SDR 3,614,449 and to use the balance--equivalent to approximately SDR 6.4 million--partially to discharge supplementary financing facility charges that had been due in July 1984. Because of those payments, the complaint of the Managing Director under Rule S-1 in relation to the SDR Department had become moot, and it was no longer necessary to make any reference in the decision to Rule S-1. If it was agreeable to Executive Directors, the draft decisions in EBS/84/262, Supplement 1 would be proposed for adoption on the understanding that the numbers would be amended afterward to take account of recent payments and that the text would be changed to reflect withdrawal of the complaint under Rule S-1. A revised decision could then be circulated later to Executive Directors for their records.

Ambassador Eissa, noting that he was speaking on behalf of the Minister of Finance and the Governor of the Bank of Sudan, observed, first, that Sudan fully recognized its commitment to eliminate its arrears to the Fund as soon as possible. The President had directed the Governor of the Bank of Sudan to make payments on those arrears, whenever the money was available, until the arrears were settled. The Sudanese Government recognized that the arrears constituted an impediment to the implementation of needed--and accepted--reforms and would therefore honor its commitment.

The Minister of Finance of Sudan had been unable to attend the present meeting because he was engaged in implementing policies in conformity with the reforms and measures recommended by the Fund, Ambassador Eissa continued. Those reforms were all acceptable in principle, and the Government was keen to pursue the Fund's policy advice. However, in implementing recommended measures, the Government intended to adopt decisions on reform that would not have to be rescinded later under pressure from the population. In that context, Directors might recall that, in April 1984, there had been a series of labor strikes in Sudan that had been defused only by the establishment of a wage commission to deal with the issue of wages in relation to the cost of living. That commission had not yet presented its recommendations; and it was the feeling of the authorities that the Sudanese people might reject any effort at reform before the commission had completed its work.

The creation of a political atmosphere conducive to change would help both the Fund and the Government of Sudan to achieve the fiscal reform policies that were intended, Ambassador Eissa considered. The authorities were willing to take action--as they had done in the past--to implement the reforms recommended by the Fund and to re-establish Sudan's credibility with the Fund and with the donor community. The only reason the accumulated arrears had not yet been eliminated was the acute shortage of foreign exchange. However, as he had earlier noted, whenever the resources became available, the authorities would direct them toward eliminating Sudan's overdue obligations to the Fund.

Mr. Abdallah said that, in the absence of specific instructions from his Sudanese authorities, his chair would endorse the statement of Ambassador Eissa.

Mr. Nimatallah asked for elaboration on the authorities' acceptance "in principle" of the measures recommended by the Fund staff.

Ambassador Eissa replied that there were certain reforms and measures--including petroleum price increases--that the Government would need to implement, even if they had not been recommended by the Fund. In order to implement such changes, with their consequent pricing implications in other areas, the authorities would have to prepare the country to accept the increases. Sudan was a country still in the midst of a strike--albeit a suspended one--pending the implementation of the recommendations of the wage commission. Certainly, further increases in the cost of living in present circumstances would not go over well with the population. Moreover, Sudan was suffering from a heavy burden of refugees on all borders and was experiencing shortages in both food and fuel. While recognizing that the agreed measures were aimed at improving the performance of the Sudanese economy, the authorities were mainly concerned about how best to implement those measures without engendering the sort of pressure that might force the Government to rescind them later.

The Director of the Middle Eastern Department added that, when the staff had visited Sudan in December 1984, it had discussed with the authorities a package of policies aimed at helping Sudan to discharge its obligations to the Fund and at giving encouragement to potential donors. At that time, the policies had not been accepted by the Sudanese authorities. More recently, discussions had again been held on a package of measures focused on exchange reform as well as on stringent fiscal and monetary policies, including price adjustments and various institutional reforms. Both the Governor of the Bank of Sudan and the Minister of Finance had agreed that they could implement the policy package. That package--together with an explanation of its price implications--had been presented to the President, who had felt that, given the suffering of the Sudanese people at present, it might not be the appropriate time to introduce such policy measures.

He had been given to understand that the wage commission had completed its report and would be recommending sizable salary and wage increases, the Director continued. Given the conflict between the need to take corrective fiscal action and the recommendations for wage increases in the commission's report, the President's desire to choose a more opportune time for implementing the policy advice of the Fund was understandable.

Mr. Grosche observed that overdue obligations to the Fund adversely affected the liquidity of the institution and the revolving nature of its resources. Moreover, by damaging confidence in the proper functioning of the Fund as the cornerstone of the international monetary system, the arrears undermined the Fund's ability to assist other member countries. It was therefore in the interest of all members--particularly those requesting financial support--that arrears to the Fund should be settled without delay.

The case of Sudan was of particular concern, Mr. Grosche continued, because it had been in arrears to the Fund for some time in rapidly rising amounts. He was pleased to note that the authorities had recently discharged some of their obligations, but he was troubled that they had not given any indication of when the remainder would be settled. In terms of the amounts involved and the prospects for discharging them, Sudan's case was the most troubling thus far in the history of the Fund. Moreover, its record of performance under successive Fund arrangements was disappointing; despite a prolonged use of a large amount of Fund resources, internal and external imbalances remained and, indeed, an alarming deterioration in the balance of payments was projected for 1985. It was clear from the staff papers that, at the root of the unsatisfactory developments he had mentioned was the inability of the authorities to maintain continuity and momentum in their adjustment effort. It should be recalled, in that regard, that the stand-by arrangement that had entered into effect in June 1984 had become inoperative only a few days after the first purchase had been made because of the emergence of arrears and the fact that agreed exchange rate measures had not been implemented. It was thus particularly disappointing that the authorities had indicated their inability immediately to implement corrective measures along the lines recommended by the staff.

He saw no reason why Sudan should be treated more leniently than any of the other cases of arrears discussed by the Board in the recent past, Mr. Grosche commented. Hence, with the amendments proposed by the Treasurer, he could support the proposed decision, which followed the usual procedure adopted in other cases. He urged the Sudanese authorities to settle their remaining arrears promptly and to adopt the necessary corrective measures to prevent an economic and financial crisis of serious proportions. He took it from the footnote on page 8 of EBS/85/30 that the World Bank shared his concerns.

Mr. Kafka said that, while he appreciated the payment recently made by the Sudanese authorities in difficult circumstances, he too remained troubled by the accumulated amount of Sudan's arrears to the Fund. The staff's proposed decision was thus, in principle, acceptable. However, he wished to draw the attention of his colleagues to a matter that had caused him some discomfort with respect to all cases of overdue obligations discussed in the Board. Article V, Section 7(g) of the Articles of Agreement provided that, by a 70 percent majority of the total voting power, an extension of the normal repurchase period might be allowed if the "discharge on the due date would result in exceptional hardship for the member." In addition, in Section 8(e) of Article V, it was provided that the Fund could permit members to pay charges in their currency "in exceptional circumstances"; and a similar "special hardship" clause had been incorporated in the Trust Fund Agreement. In his view, the Fund should clearly define the term "exceptional hardship," because there might be cases--and Sudan could easily be one of those--where immediate payment would cause exceptional hardship and where, therefore, special procedures could be followed.

Mr. Blandin recalled that, on other occasions, he had pointed to the absence of continuity in economic policy as the main factor behind the deteriorating performance of the Sudanese economy, which had led to the accumulation of large arrears to the Fund. Like the staff, he believed that drastic changes in economic policy were the only means of improving Sudan's external position so as to make possible the repayment of its obligations to the Fund. It was clear that Sudan would be able fully to discharge its present and future obligations to the Fund only if overall exports were boosted by an increase in oil exports in the years ahead. Policy changes should therefore encompass all the steps necessary to make possible the resumption of oil exploration in the south.

Until exports improved and Sudan began to eliminate its overdue financial obligations to the Fund, the size of the arrears would continue to jeopardize the Fund's income position and might lead the institution to increase the rate of charge for all borrowers as a counterbalancing measure, Mr. Blandin continued. He hoped that such a situation could be prevented, and he fully supported the proposed decision to limit Sudan's right to use the resources of the Fund, which was the step taken before a formal declaration of ineligibility. Finally, while welcoming the payments recently made by the Sudanese authorities, he urged them to discharge promptly all remaining obligations to the Fund and to implement immediately the sorts of policy changes that would put Sudan in a position to settle the arrears.

Mr. Wijnholds agreed with Mr. Grosche that, in terms of the amounts involved, Sudan was by far the most important case of overdue payments to the Fund with which the Executive Board had had to deal. The stance adopted by Sudan, as described in the opening statement of the staff, only added to the gravity of the situation. His authorities were deeply concerned about the problem of Sudan's arrears. Sudan had received considerable aid in previous years and was at present risking a significant cutback in such flows through the Government's refusal to make a sufficient adjustment effort.

Another element to be considered was the effect that nonpayment by Sudan might have on the Fund's ability to obtain necessary resources in future, Mr. Wijnholds continued. Unless the situation improved markedly, Sudan would be faced with arrears of the magnitude shown in the table on page 4 of EBS/84/262, and the Fund's income position would accordingly be adversely affected.

The occurrence of overdue payments to the Fund had become so frequent that the Executive Board had been forced to begin developing a standard approach to the problem, Mr. Wijnholds observed. The proposed decision in EBS/84/262, Supplement 1 followed the practice of previous cases and, on the basis of the important principle of uniformity of treatment of members, he could support it with the amendments suggested by the Treasurer. However, the adoption of the proposed decision should not be viewed as the end of the Executive Board's work with respect to the case of Sudan. It was important for the Board to look at what had gone wrong in Sudan and to see what lessons, if any, could be drawn from the experience.

The case of Sudan--which had made use of Fund resources continuously for nearly 20 years--highlighted the problem of prolonged use of Fund resources, Mr. Wijnholds remarked. After reviewing the history of Sudan's adjustment effort, the staff had made a number of suggestions for dealing with the country in future, in the event that financial support by the Fund were again to be made available. The staff felt that a greater reliance on prior actions would be necessary, and it also saw a need for more conservative estimates of the balance of payments financing gap. He agreed with the recommended approach, which could also be followed in other similar cases. Moreover, it might be useful to have a debt verification exercise at an early stage of the Fund's involvement in countries with a weak statistical base. In the case of Sudan, the underrecording of external debt and debt service payments--undiscovered before 1982--had been huge. Finally, in reiterating his support for the proposed decision, he wished to underline his disappointment in the reaction of the Sudanese Government to the policy recommendations of the Fund. While he was sympathetic to the plight of the country, particularly given the extent to which external factors had been involved in its difficulties, he was troubled that the authorities had chosen to risk endangering their long-standing good relations with the Fund through their refusal to make a sufficient effort to resolve the country's economic problems at present.

Mr. Alfidja, welcoming the partial payment made recently by the Sudanese authorities, stated that he could support the request by Mr. Kafka for a definition of the term "special hardship" referred to in the Articles of Agreement. He himself had made a similar request on at least one other occasion.

Mr. Leonard said that, like others, he welcomed the recent payment by the authorities aimed at clearing some of Sudan's outstanding obligations to the Fund. However, the remaining obligations totaled more than SDR 100 million, and even that figure was small by comparison with the potential arrears of nearly SDR 1 billion--an amount equivalent to the Fund's present reserves--that could arise if Sudan were to continue to fail to meet its obligations for the remainder of the decade. In the amounts alone, the failure of Sudan to eliminate its arrears constituted a serious problem for the Fund, which had been made even more serious by the apparent unwillingness of the Sudanese authorities to move toward a solution to the problem through adjustment measures. In light of the long history of interrupted efforts to adjust the Sudanese economy, the latest immobility was most disquieting.

While sharing with others both sympathy and understanding for the difficulties confronting Sudan, his chair found it difficult to determine the best course of action for dealing with them, Mr. Leonard continued. Very little room was left for a deviation from the procedures that had been followed in dealing with other members in arrears; in that regard, the terms of the proposed decision were to the point. The question was not simply one of procedure. The main concern was, rather, to find ways of resolving the arrears problem. In EBS/85/30, the staff had indicated two conditions that were necessary for settlement of the obligations due to the Fund and for bringing the Sudanese economy back on course: "bold and comprehensive domestic policy initiatives"; and "additional support by the international community in the form of exceptional aid and debt relief over and above the already assumed levels." He had no doubt that the latter condition would never be met unless the former was fulfilled. In that respect, the fate of Sudan was in the hands of its authorities.

Assuming the proposed decision was approved, the Fund should make every effort to make clear to the Sudanese authorities that prompt settlement of all overdue financial obligations would be required if normal relations with the Fund and the future well-being of the Sudanese economy were to be protected, Mr. Leonard commented. In particular, it must be understood that there were limits to the extent to which the Fund could allow its resources to be "locked up" for long periods under arrangements with its members. Finally, his chair could support the proposed decision with amendments suggested by the Treasurer.

Mr. Nimatallah observed that, if the proposed decision were to be adopted, Sudan would have three months before the next review to resolve the arrears problem. Before taking a position on the proposed decision, he would appreciate hearing from Ambassador Eissa what action the Government of Sudan intended to take within the three-month period.

Ambassador Eissa replied that he was in no position to specify precisely what the Government would do in the period referred to by Mr. Nimatallah. He could nonetheless assure Executive Directors that the Government of Sudan valued its relationship with the Fund and was fully aware of the adverse implications of its continuing arrears, which was why the President had directed the Minister of Finance and the Governor of the Bank of Sudan to make the elimination of Sudan's overdue obligations to the Fund a matter of priority. Such action was all the more important because the arrears constituted an impediment to a much needed stabilization program that might otherwise be supported by the Fund.

The Government of Sudan had stated simply that there was no foreign exchange available to repay the Fund, although there were mechanisms that, if implemented, might place Sudan in a position to obtain some foreign exchange, which would of course be directed toward the settlement of arrears to the Fund, Ambassador Eissa continued. At present, all types of aid to Sudan, both bilateral and multilateral, had been frozen. If a way could be found to unlock the aid, Sudan would be better placed to move toward settling its overdue financial obligations.

As he had noted earlier, the authorities were having great difficulty in providing petroleum for day-to-day activities in Sudan, Ambassador Eissa remarked. Also, because of the drought, both the irrigated and rain-fed agricultural sectors would be severely affected unless agricultural inputs could be provided over the next several weeks. In the circumstances, the authorities had to use a very limited amount of foreign exchange to meet the day-to-day needs of the country, to provide the agricultural inputs to ensure production in 1986, and to pay the Fund. Repaying the Fund remained a priority objective, although whether it was fulfilled within the next three months or the next three days depended entirely on the cooperation and understanding of the international community and the multilateral corporations in unlocking the frozen aid so as to make available the foreign exchange necessary to settle Sudan's arrears to the Fund.

Mr. Nimatallah agreed that the world community must be cooperative if Sudan's problems were to be resolved. However, Sudan must itself take action and not depend only on the release of frozen aid. In fact, by taking the initiative and by demonstrating its willingness to act, Sudan might well stimulate the very action within the world community that the authorities felt was needed.

The Director of the Middle Eastern Department remarked that it was important not only for Sudan to take the initiative in adopting an acceptable policy package; it must do so without delay so as to avoid the necessity for harsher or less palatable measures in future.

Mr. Romuáldez expressed the appreciation of his chair for Ambassador Eissa's explanation of the Sudanese position, for the authorities' recent payment, and for the indication that all policy measures recommended by the Fund staff had been accepted by the authorities, even if only in principle. On the grounds of uniformity of treatment, and because differences in relative circumstances confronting Sudan appeared to him insufficient to justify a different approach, his chair could support the proposed decision with the amendments suggested by the Treasurer. It should be stressed, in that context, that the requirement of uniform treatment need not be understood to mean that the Sudanese case was in no way different in its implications from other cases that had come before the Executive Board. Clearly, given the magnitude of the amounts involved, there was a difference.

The establishment of the three-month review period should not be regarded as a period of grace; rather, while a member was at all times obligated to effect a prompt and full settlement of its overdue obligations to the Fund, three months appeared a reasonable length of time to judge the member's intentions and performance, Mr. Romuáldez continued. That should also give the Fund time to reflect on the wider implications of the case in question, so as to allow the formulation of an appropriate response at the time of the review. On that latter point in relation to the case of Sudan, two distinct issues confronted the Fund: how best to ensure that Sudan could service its debts to the Fund; and what lessons could be learned for the future. With regard to Sudan's payments prospects, it was clear that the authorities would need to adopt drastic measures in order to arrest any further deterioration in the economy and to strengthen the financial situation. What was not clear was the extent to which they would be able to become current in their obligations to the Fund within the three-month period, even if they were to undertake an abrupt reversal of policy and follow the approach recommended by the staff. Did the staff really expect that the adoption of a comprehensive adjustment package would be sufficient to ensure prompt and full settlement of Sudan's arrears? In that sense, the staff paper was lacking in a quantitative assessment of Sudan's likely debt-servicing capability if necessary policies were implemented in the near future.

Of course, the burden of proof in justifying any kind of postponement or rescheduling of payments under the Articles of Agreement rested with the member, Mr. Romuáldez commented. It was thus incumbent upon the Fund to have a realistic appreciation of what might be achieved under the most favorable scenario. A postponement of repurchases beyond their normal due date was equivalent to the extension of new credit to the member and, unless accompanied by adjustment policies, was unlikely to serve as any more than a temporary palliative. In the circumstance, any Fund assistance would best be associated with further programs of adjustment under new arrangements. He agreed that rescheduling per se would not address the fundamental causes of extended delays and would, moreover, be detrimental to the credibility of the Fund as a source of relatively short-term and conditional balance of payments support.

Given the magnitude of the arrears problem, both for Sudan and the Fund, it was inevitable that Sudan's difficulties, if they persisted, would have repercussions on Fund policies and upon other members with respect to both the design of Fund programs and the Fund's income and financial position, Mr. Romuáldez said. Since the issue of the design of programs had been discussed at great length in the Executive Board on December 5, 1984 (EBM/84/174 and EBM/84/175), he would limit his comments to the repercussions of Sudan's difficulties on the Fund's income and financial position. Overdue obligations, particularly of the magnitude seen in the case of Sudan, would reduce the Fund's net income position and place the institution at some risk. It appeared that, until end-1985, Fund income could be affected by delayed charges amounting to nearly SDR 90 million and delayed repurchases of about SDR 160 million. He would be interested in hearing the staff's estimate of loss of income in fiscal year 1985 resulting from Sudan's overdue charges and repurchases and how that figure compared with the estimate of SDR 3 million made at the time the Fund's financial procedures had first been discussed in the Executive Board. He wondered whether it was still possible for the staff to state that overdue obligations were not yet of sufficient magnitude to affect the Fund's financial policies.

Mr. Dallara stated that he continued to believe that Sudan's overdue payments to the Fund were a matter of serious concern, with implications not only for Sudan but for all Fund members as well as for the financial integrity of the institution. He welcomed the payments recently made but noted that they fell short of what was required to bring Sudan current in its obligations to the Fund; indeed, the payments were significantly less than the SDR 30 million in obligations to the Fund that had accrued only since the previous Board discussion on Sudan. In that respect, the payment did not provide him with the necessary assurances that Sudan's arrears would be eliminated promptly.

At present, Sudan's arrears were equivalent to 50 percent of its quota, a ratio twice as large as that of any other Fund member in arrears with the exception of Democratic Kampuchea, Mr. Dallara continued. Sudan's arrears clearly had important implications for the Fund's income position, the level of charges, and the level of reserves; and those implications must be faced in a broader context by Executive Directors at a future meeting. Sudan's situation, while difficult, was particularly discouraging because of the apparent unwillingness of the Sudanese authorities to formulate and rapidly implement an appropriate adjustment program. Following extensive efforts by the Fund, a program had been developed and initiated in Sudan in 1984; unfortunately, Sudan had fallen out of compliance with the program shortly thereafter, and, since then, further discussions had been held between the staff and the authorities. It was worth noting that the Fund had gone some distance in its efforts to discuss with the Sudanese authorities the measures that could help to restore growth and confidence in the economy. Unfortunately, merely accepting such measures in principle would not resolve Sudan's economic problems; the authorities must implement those measures.

He had been pleased to hear that Sudan valued its relationship with the Fund, Mr. Dallara said. However, the authorities' lack of action in the face of the mounting arrears problem over the past few months conveyed a somewhat different impression. The path to resolving Sudan's problems lay not through "exceptional hardship" clauses or other special provisions in the Articles of Agreement but rather through the immediate formulation and implementation of a comprehensive adjustment program in order to restore the confidence of the international community and enable Sudan to discharge its financial obligations to the Fund. In that connection, he had noted with interest the remarks of Ambassador Eissa regarding the search for a mechanism to unlock the resources that a cooperative international financial community could provide. In his view, that mechanism was precisely the comprehensive adjustment program recommended by the staff.

He was prepared to support the proposed decision with the amendments suggested by the Treasurer, Mr. Dallara remarked. However, like Mr. Nimatallah, he was interested in hearing what plans the authorities were making to settle their arrears to the Fund during the three-month period before the next review. He was concerned by the response of Ambassador Eissa, which did not provide him with the assurances that the arrears problem would be settled promptly. In passing, he noted that the language of the proposed decision provided for a review "within a period of three months from the date of the decision." In light of the seriousness of the Sudanese case, he would expect that action by the Sudanese authorities would be monitored closely during the three-month period and that management would not rule out the possibility of bringing the review to the Executive Board before the end of the three months if circumstances warranted.

Mr. Wicks stated that, like others, he was pleased by the recent payment by Sudan of $10 million, which he took as an indication of the authorities' wish to maintain a good relationship with the Fund. However, Executive Directors in his view had no option but to support the proposed decision, as amended by the Treasurer, in order to maintain the financial integrity of the Fund and to protect the interests of other members.

He agreed with the staff that any delay in taking the necessary economic measures would only exacerbate Sudan's difficult situation, Mr. Wicks continued. Moreover, a delay would mean that, when the measures were eventually taken, they would need to be even more severe if adjustment was to occur. Like Mr. Nimatallah, Mr. Dallara, and others, he considered that the key to progress was in the hands of the Sudanese authorities themselves, and he urged them to adopt the policy package recommended by the staff. Finally, with regard to Mr. Kafka's interesting comments on the "exceptional hardship" provisions of the Articles of Agreement, he believed that the wrong impresssion would have been given if anyone were to draw the conclusion that Mr. Kafka's comments were relevant to the case of any particular member.

Mr. Zecchini remarked that the Sudanese case was a particularly serious one because of the large amount of overdue payments involved, the possibility of a rapid increase in that amount, and the likely difficulty in obtaining a settlement of such sums in a relatively short period of time. Sudan's overdue obligations were at present equal to about SDR 100 million, a figure that could increase rapidly in the near future as payments amounting to SDR 170 million fell due during 1985 and obligations of a similar magnitude came due in the following years. Sudan's arrears were staggering when compared with the amounts of SDRs overdue by other countries whose cases had been discussed recently in the Executive Board. Moreover, the background paper prepared by the staff (EBS/85/30) showed that the authorities had contributed to the problem through their lack of commitment in implementing the necessary adjustment measures. One indication of the authorities' lack of commitment was the fact that only one out of the four programs approved for Sudan by the Fund in the period from 1979 to 1984 had been completed; and two stand-by arrangements and an extended arrangement had been interrupted. Even more troubling was the apathy that the authorities had shown in the past few months; they must understand that further delays were unacceptable and that stringent and wide-ranging measures must be adopted immediately if the economy was to cope with its current difficulties. Strong corrective action was also needed to stimulate foreign aid and negotiations for a rescheduling agreement with the banks.

He could support the proposed decision as amended, including the three-month period for a review of the decision, Mr. Zecchini stated. However, he had some reservations with respect to paragraph 4(c) of the text, which dealt with the relationship between overdue obligations to the Trust Fund and the member's eligibility to make use of the general resources of the Fund. If it was intended that no use of the Fund's general resources would be allowed if the member was not current in the Trust Fund as well as in the General Department, that point should be clearly stated.

Mr. Pérez agreed with those colleagues who had noted that Sudan represented the most serious case of overdue financial obligations to the Fund with which the Executive Board had yet been faced. The speed with which arrears had accumulated, the overall amount of Fund resources involved, and the severe internal and external economic difficulties experienced by Sudan made it unlikely that a satisfactory solution to the problem would be reached in the short run. During the recent Article IV consultation with Sudan, it had been noted that the country was facing a severe economic and financial crisis. The economic imbalances undermining the country implied a continuous and accelerated deterioration in the external payments position. A reversal of that trend would require not only the immediate implementation of a comprehensive package of corrective measures but also a renewal of support from the international financial community so as to make the recommended economic program feasible. In that respect, the delay in implementing the specific package of measures recommended by the Fund staff to the Sudanese authorities during its recent visit to Khartoum was a matter of concern. He agreed with the staff that the first step to be taken was the adoption of a strong and comprehensive adjustment program aimed at eliminating existing disequilibria. Because the proposed decision fell within the general policy framework followed thus far by the Fund in respect of overdue obligations, he could go along with it, with the amendments suggested by the Treasurer.

Mr. Fujino said that, while he was fully aware of the difficulties experienced by Sudan, he shared the concern of Mr. Grosche and others that, despite recent payments--which he welcomed--the Sudanese authorities had given no clear indication that they would be discharging their remaining overdue obligations. In the circumstances, the Fund had no alternative but to take some action, and he could therefore support the proposed decision as amended.

Mr. Salehkhou remarked that, in recent months, the Executive Board had held extensive meetings on both the general question and specific cases of overdue financial obligations to the Fund. One theme that had been underlined and emphasized in those deliberations was the necessity to preserve the revolving character of the Fund's resources, the credibility and financial integrity of the institution, and the principle of uniform treatment of members. Other points of focus had been the need for flexibility and understanding toward members in arrears suffering from severe hardship.

In the recent cases of Viet Nam and Nicaragua, the Board had implicitly recognized that a gesture of good intention--notwithstanding the financial difficulties of the member--would be taken into consideration, Mr. Salehkhou continued. The concept of evenhanded treatment of members could be taken to mean that it was incumbent upon the debtor country to accord uniform treatment to all its creditors, including the Fund. The oft-expressed view that the debtor should accord the Fund preferential treatment vis-à-vis other creditors, including other financial institutions, might be difficult to justify, given the high degree of rigidity introduced into the Fund's approach to payments arrears, which might be in contrast to the reasonable degree of understanding and cooperation shown by other creditors on the basis of the exceptional hardships experienced by the debtor. In his view, it was unclear how a defaulting member with overdue debts to both the Fund and to another multinational institution could arrange its order of preference between the two institutions while, at the same time, escaping the ineligibility proceedings of one or the other. The rigidity currently inherent in the Fund's approach would make it impossible for such a member to make partial payments to, yet maintain a working relationship with, both institutions. In any event, the global role of the Fund dictated that any approach to such problems should be based on consideration of wider dimensions of the question.

Making a distinction between members in arrears to the Fund on the basis of their willingness and/or ability to pay was important because, if there was ample evidence that a member was unable to honor its financial obligations to the Fund and to other creditors because of a crisis of solvency, then punitive action would only distance the member further from the Fund without achieving the desired results, Mr. Salehkhou commented. The case was somewhat different for those able but unwilling to pay. The position of his chair had always been consistent on the issue at hand. He strongly believed that debtor countries should not discriminate among creditors--including the Fund and other such institutions--on account of political or other considerations. For the creditors' part, once it had been determined that the debtor country was insolvent, then assistance and understanding should be accorded the debtor to the extent possible; punitive action should be taken only in cases where recalcitrance had been established beyond reasonable doubt. In the case of Sudan, the differentiation between the country's willingness and ability to pay had not in his view been clearly drawn.

Sudan's arrears to the Fund were quite large, and the prospects for economic improvement were not bright, Mr. Salehkhou observed. The deterioration in economic conditions had occurred over a period during which Sudan had been a prolonged user of Fund resources, particularly in more recent years. In that respect, he agreed with those who had observed in the December 1984 Article IV consultation with Sudan (EBM/84/187) that, when the new stand-by arrangement had been approved in June 1984, some reference should have been made in the staff report to the looming crisis and to Sudan's impending liquidity and solvency problems. It should be recalled that, during the June Executive Board Meeting (EBM/84/94, 6/15/84), his chair had specifically referred to the financing gap, which had not taken into account a sizable unpaid loan to a member of his constituency.

In EBS/85/30, the staff had referred to its discussions with the authorities and to a memorandum containing a proposed program of adjustment, Mr. Salehkhou noted. The program was apparently based on the fact, as ascertained by the staff, that reliance on domestic efforts alone could not close the residual external gap and could adversely affect the economic situation in Sudan. A less severe program had then been recommended, and he wondered about the extent to which the amended version was compatible with the current institutional, economic, and social framework of the country. Furthermore, in view of the authorities' indication that the staff's proposed program could not be immediately implemented, he was unclear about the prospects for adjustment in the near future. Irrespective of the soundness of the methods and procedures currently being implemented in Sudan, common practice regarding relations between the Fund and member countries demanded that those methods be accepted at face value and that the recommendations of the staff should duly acknowledge their existence and sanctity. In that respect, the Fund's recommendations should be adapted to fit the economic framework of the country as had been done, for example, in the cases of members with centrally planned economies.

Mr. Nebbia remarked that, like others, he could support the proposed decision as amended. Although welcoming the latest payment by Sudan, he noted that $10 million represented only about 10 percent of Sudan's current outstanding arrears to the Fund, an amount that had been growing steadily since mid-1984 and, in the absence of decisive action by the authorities, would continue to grow. By end-1985, Sudan's overdue obligations to the Fund could represent nearly 40 percent of the country's projected export earnings; in the circumstances, even assuming that the authorities were successful in reaching agreement with other creditors, the need for a comprehensive adjustment effort would continue to be crucial. Failure to make such an effort might aggravate the domestic and external imbalances in the economy and have an adverse impact on the potential for further credit from abroad, which in turn could lead to a situation even worse than the current one. He welcomed the indication that the Sudanese authorities were prepared to implement a number of measures recommended by the Fund, although he would have preferred a clarification of how the remaining overdue obligations would be settled.

Mr. Zhang said that he too could support the proposed decision as amended by the Treasurer. He agreed with those who felt that it was important for the Sudanese Government to implement the recommended adjustment program in order to release frozen aid resources; at the same time, he agreed with Mr. Kafka that the Fund should make an effort to define the term "exceptional hardship" so that, if warranted, certain relevant provisions of the Articles might be applied.

Mr. Nimatallah commented that, like others, he could support the proposed decision with the amendments suggested by the Treasurer. However, in addition, he hoped that Ambassador Eissa would convey to President Nimeiri the concern of the Executive Board with respect to Sudan's arrears and the importance it attached to a clear indication of positive action by the Government of Sudan. In that regard, it would be appreciated if President Nimeiri could send a letter to the Managing Director indicating that Sudan was willing to adopt the policy measures recommended by the Fund.

Mr. Vasudevan considered that the problem of Sudan's arrears to the Fund was unlikely to be resolved through a standard approach. The Fund had sent special missions to Sudan to help analyze the problem, but it was not clear how the resulting recommended measures would help Sudan to repay its overdue obligations within the next three months. If Directors felt that the adjustment measures recommended would not lead to a prompt and full settlement of Sudan's obligations, that conclusion might indicate that the case of Sudan was exceptional; and it was in that context that he was in sympathy with Mr. Kafka's remarks regarding the "exceptional hardship" clauses in the Articles of Agreement.

Recalling a reference in one of the staff papers to the catalytic role that the Fund might play in helping Sudan to discharge its arrears, Mr. Vasudevan said that he was not clear about the precise nature of that role; however, as a practical matter, it was obvious to him that Sudan would not be able to discharge its overdue obligations to the Fund over the next three months, no matter how aggressively the authorities undertook to implement the recommended adjustment measures. In the circumstances, Sudan must be given confidence that the international community would come forward with help if the authorities undertook some steps toward adjustment; and perhaps the Fund should clearly indicate what was expected as minimum action before further international support was likely to be provided. It was in that sense, perhaps, that the "catalytic" role of the Fund could be defined.

Mr. Alhaimus indicated his support for the proposed decision as amended.

Mr. Lindø said that he too could support the proposed decision.

The Director of the Middle Eastern Department observed that, if Sudan were to initiate a credible program that led to a restoration of confidence within the international community, it would certainly be easier for the authorities to resolve the arrears problem than had been the case thus far. To restore that confidence, Sudan must take the initiative; further delays would only aggravate the situation.

Some Directors had requested quantitative details on the package of policies recommended by the staff, the Director recalled. Some quantification had been provided to the Sudanese authorities by the staff mission that had visited Khartoum in December 1984, on the assumption that the recommended measures would be initiated by January 1, 1985. Since the measures had not been acceptable to the authorities at the time, the staff had seen no need to present to the Board the staff's analysis of their likely effects.

The Treasurer observed that the staff had not calculated the income loss to the Fund of Sudan's overdue obligations. However, of the total overdue obligations outstanding following the most recent payment, some SDR 44 million was overdue charges, an amount equivalent to about one half of the total of overdue charges of all other members. In that respect, the implications of Sudan's overdue charges for the Fund's financial position should not be underestimated. Some of Sudan's charges had been overdue for more than 180 days; and the Executive Board would need to consider what impact, if any, those unpaid charges should have on the Fund's reserve policy and financial statements. A rough estimate of the effect of Sudan's arrears on the Fund's income was perhaps one third of the total loss attributable to overdue payments, equivalent to approximately SDR 3 million a year, which had been projected for the current fiscal year in an earlier staff paper dealing with the effects of overdue obligations on the Fund's income and reserves.

In his view, it was not only the income loss that was at issue in looking at Sudan's and others' arrears to the Fund, the Treasurer continued. A very real concern was the loss of credibility--which was not quantifiable in terms of income--faced by the Fund when members did not pay their obligations on time.

The Director of the Legal Department, responding first to a question by Mr. Zecchini, noted that the text of paragraph 4(c) of the proposed decision had been carefully drafted by the staff. The Fund had no authority to declare a member ineligible or to limit the use of its resources by a member or to extend that limitation simply because the member was delinquent in its obligations to the Trust Fund. All the Fund could do was to take account of the delinquency in making a determination regarding the use of the Fund's general resources by the member.

In reply to a point raised by Mr. Dallara, the Director indicated that it would indeed be possible under the text of the proposed decision for the Executive Board to review the decision any time within the three-month period specified in paragraph 5 if developments justified such a change.

Mr. Zhang inquired whether the Sudanese Government was being asked only to adopt the measures recommended by the staff or also to guarantee that their adoption would produce certain results within the three-month period.

The Director of the Middle Eastern Department replied that the measures in question would of course yield better results over a few years than over three months, but they could certainly produce some short-term beneficial effects, such as helping to restore Sudan's credibility in the eyes of the international community and, perhaps, stimulating workers' remittances and helping to stem imports of certain commodities. The measures were not expected to encourage exports, because the major crops had already been harvested.

The staff had quantified, in consultation with the Sudanese authorities, the main macroeconomic objectives for calendar year 1985 and had recommended the measures that would be necessary to achieve those objectives, the Director continued. It had originally been intended to have the recommended policies in place by January 1, 1985, although a delay of nearly six weeks had taken place, and many of the numbers needed to be recalculated. For example, the estimate for the balance of payments gap had changed between December and the present because new data on crops that had been adversely affected by the drought indicated that exportable output was lower than had been projected in December.

Ambassador Eissa, noting that the thrust of Executive Directors' observations would be conveyed to the authorities in Sudan, remarked that there were two issues faced by the Government at present. The first was the problem of accumulating arrears, which the Government would do all in its power to address. The second was related to the package of policy measures recommended by the Fund staff. Executive Directors should understand that the authorities had accepted the reforms and measures in question and would implement them once a way was found of making them sufficiently palatable to the population that the Government would not be forced to rescind the measures. In that regard, the Minister of Finance had been unable to represent Sudan at the present Board meeting because he was in the process of implementing some of the measures in the package. Finally, with regard to the repayment of arrears, he repeated that the President had directed the Governor of the Bank of Sudan to make the elimination of arrears to the Fund a priority issue. Payments would continue to be made as soon as the foreign exchange was available.

Mr. Abdallah welcomed the fact that Ambassador Eissa had been able to hear for himself the views of the Executive Board with respect to Sudan's arrears to the Fund. Sudan had been treated, in his view, with the same understanding and impartiality that had been accorded other countries in a similar situation. The principle of uniformity of treatment was a sacred one, and it was therefore appropriate that the proposed decision was likely to be adopted.

Since the international community was fully represented at the Executive Board, Sudan could be assured that, if the package of economic measures recommended by the Fund were to be fully implemented, the resources needed by Sudan to import essential goods and services while repaying its creditors would be made available. Besides, Sudan had no option but to take the initiative and move toward adjustment; any further delay would only aggravate the situation. Of course, he understood the authorities' hesitancy to act before the recommendations of the wage commission had been published, but the time for waiting was ended. It was the duty of the Executive Board to convey to the authorities in Sudan the need for immediate and forthright action.

The Executive Board then adopted the following decision:

1. The Managing Director has reported under Rule K-1 and Rule S-1 of the Fund's Rules and Regulations to the Executive Board the facts on the basis of which it appeared to him at the dates of these reports that Sudan was not fulfilling its obligations under the Articles of Agreement and submitted complaints on December 12, 1984 (EBS/84/262) in accordance with those Rules. The complaint under Rule K-1, as amended January 9, 1985, was that, as of January 9, 1985, Sudan was not fulfilling its obligations relating to repurchases and the payment of charges in the General Department in the total amount of SDR 76,209,469. The complaint under Rule S-1, as amended, was that, as of January 9, 1985, Sudan was not fulfilling its obligation to pay charges in the SDR Department in the total amount of SDR 2,497,098. Furthermore, the Managing Director added to his complaints a notice of the facts on the basis of which it appeared to him that, as of January 9, 1985, Sudan was not fulfilling its obligations under Decision No. 5069-(76/72) on the Trust Fund to repay a disbursement and to pay interest in the total amount of SDR 3,153,577. These facts, and the complaints and notice of the Managing Director, have been communicated to the authorities of Sudan.

2. Taking into account the further obligations of Sudan that have become overdue since January 9, 1985, as well as payments received, Sudan's overdue obligations to the Fund now amount to SDR 99,098,497 in the General Department and SDR 7,844,192 under the Trust Fund. As a result of payments received since January 9, 1985, Sudan is now current in its obligations in the SDR Department, and the complaint under Rule S-1 is therefore withdrawn.

3. Having considered the report of the Managing Director, the complaint under Rule K-1 and the notice, and the views of Sudan, the Fund finds that Sudan has failed to fulfill obligations under the Articles of Agreement and the Trust Fund as stated in 2 above.

4. The Fund regrets the nonobservance by Sudan of these obligations and urges Sudan to resume its observance forthwith. The Fund decides

(a) pursuant to Rule K-2 of the Fund's Rules and Regulations that Sudan shall not make use of the general resources of the Fund until such time as Sudan is current in its obligations under the Articles of Agreement relating to repurchases and the payment of charges in the General Department, and

(b) if Sudan were otherwise eligible to make use of the general resources of the Fund, to take into account the existence of any overdue obligation to the Trust Fund in considering any request by Sudan for the use of the general resources.

5. The Fund shall review this decision within a period of three months from the date of the decision.

Decision No. 7903-(85/20), adopted
February 8, 1985

APPROVED: November 6, 1985

LEO VAN HOUTVEN
Secretary