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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/60

10:00 a.m., April 23, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. K. Bush
J. de Groote	
	C. Flamant, Temporary
	T. Alhaimus
H. Fujino	
	B. Goos
J. E. Ismael	
R. K. Joyce	
	J. Hospedales, Temporary
	H. Fugmann
	A. Abdallah
	W. K. Parmena, Temporary
	B. Jensen
	J. E. Suraisry
P. Pérez	
J. J. Polak	
C. R. Rye	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	A. S. Jayawardena
	T. A. Clark
S. Zecchini	
	Wang E.

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

A. E. Elmendorf, Eastern and Southern Africa Regional Office, IBRD. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; N. Abu-zobaa, Buu Hoan, J. W. Kratz, R. H. Nord, M. Sidibé, J. C. Williams. Exchange and Trade Relations Department: S. Kanesa-Thasan, A. K. Mitchell. Legal Department: J. G. Evans, Jr., Deputy General Counsel; J. M. Ogoola. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Gupta, T. B. C. Leddy, B. B. Zavoico. Advisors to Executive Directors: G. R. Castellanos, D. Hammann, J.-C. Obame, G. W. K. Pickering, A. Vasudevan. Assistants to Executive Directors: G. Ercel, R. Fox, G. D. Hodgson, A. R. Ismael, Z. b. Ismail, A. K. Juusela, H. Kobayashi, M. Lundsager, A. Mustafa, A. A. Scholten, Shao Z., A. J. Tregilgas.

1. MADAGASCAR - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on Madagascar's request for a one-year stand-by arrangement in an amount equivalent to SDR 29.5 million, or 44.4 percent of quota, and containing a draft decision on Madagascar's exchange system (EBS/85/82, 4/1/85). They also had before them a paper on recent changes in the exchange arrangements of Madagascar (EBS/85/81, 3/29/85).

The Deputy Director of the African Department pointed out that in paragraphs 6, 10, and 12 of the letter of intent the Malagasy authorities had undertaken to implement certain measures prior to April 15, 1985. The Minister of Finance and Economy had advised the staff that all the agreed measures had been taken. Thus, in conformity with the understanding in paragraph 6, importers had been notified on April 13, 1985 of the procedures applicable for the introduction of the liberalized system of imports.

In accordance with paragraph 10, the Deputy Director continued, the Board of Governors of the Central Bank of Madagascar had decided on April 10, 1985 to decontrol all bank rates, with the exception of those applying to 6-12 month deposits by individuals and the Central Bank's discount rates. Those rates still subject to control had been reduced by 1.5 percent, reflecting the decline in the rate of inflation. The banks had already been notified of those decisions. In conformity with paragraph 12, by decree dated April 9, 1985 the Government had extended to all exporters of goods--except exporters of traditional products--the current EPI account system, which permitted certain exporters to retain a percentage of their foreign exchange receipts to finance part of their imports of raw materials and spare parts.

The Malagasy authorities had requested that the Paris Club reschedule certain of the external obligations coming due in 1985, the Deputy Director of the African Department added. The staff expected that the request would be on the Paris Club agenda for May.

Mr. Alfidja made the following statement:

> Over the past 12 months, the Executive Board has had the opportunity to examine in great detail the performance and prospects of the Malagasy economy, in the course of the review under the stand-by arrangement and the conclusion of the 1984 Article IV consultation. The adjustment policies followed by the authorities to correct the large domestic and external imbalances that had characterized the economy in past years had begun to bear fruit. As reported by the staff, all the policy measures agreed under the 1983/84 program were implemented, the performance criteria were observed, and many of the program targets were surpassed.

In the real sector, higher agricultural output has contributed to the more rapid growth of real GDP (1.8 percent) than programmed (1 percent). The growth performance of the Malagasy economy in 1984 would have been stronger had the projected increase in imports of raw materials and spare parts envisaged under the program been realized. In the fiscal sector, thanks to a 70 percent expansion in receipts of the export crop stabilization fund and a continued restraint in total expenditure, the overall fiscal deficit was lowered to 4.8 percent of GDP in 1984 compared with 6.7 percent in 1983. Growth in credit to both the government and private sectors was broadly in line with the program's forecasts, as was the external current account deficit.

Although satisfactory progress was made under the 1983/84 program, the financial imbalances in the economy are still serious. Consequently, my Malagasy authorities are furthering their adjustment effort under a new program in support of which they are requesting Fund financial assistance under a one-year stand-by arrangement. This program is aimed at consolidating the gains made in stabilizing the finances of the economy and providing the basis for the promotion of growth in the major sectors of the economy, especially in the export sector. The importance of the latter cannot be overemphasized in light of the large amount of resources needed to service the external debt obligations. The decontrol of the pricing and marketing arrangements will be pursued and production incentives will be reinforced. The rehabilitation of the public enterprises will be continued and the flexible exchange rate policy maintained.

In the fiscal sector, the authorities plan to continue their policy of restraint so as to keep the deficit at 4.7 percent of GDP in 1985. Increases in expenditure will be kept below 10 percent by limiting public employment and by restraining the growth of the wage bill. Investment expenditure will, however, increase by 22 percent, in line with the level of spending envisaged under the program being discussed with the World Bank. A large part of this increase in capital outlays is due to a carryover of some 1984 projects that were not implemented owing to delays in foreign aid disbursement. On the revenue side, increased economic activity and improved tax collection are expected to contribute to a better performance.

In the monetary sector, the main objective will be to provide the necessary liquidity to support the anticipated increase in economic activity due to the implementation of liberalization policies while containing inflation. Total domestic credit, therefore, is forecast to expand by about 13 percent in 1985. Interest rates, except for the central bank discount rates and the minimum rate on individual deposits of 6-12 months, will be decontrolled.

Developments in the external sector are projected to result in a current account deficit amounting to the equivalent of between 9.7 percent and 10.4 percent of GDP depending on the evolution of imports. Export growth will be encouraged through the elimination of taxes on nontraditional exports and the maintenance of a flexible exchange rate. Imports are expected to show some increase, mainly because of a carryover of delayed aid disbursement from 1984.

Finally, my Malagasy authorities have asked me to draw the attention of the Fund's management and the Executive Board to the following issue. Over the past few years, the Government has moved decisively to implement wide-ranging policies, the outcome of which has been major improvements in several sectors of the economy. However, as stated in the letter of intent and in several passages of the staff paper, my authorities are of the firm view that further progress toward restoring viability in their economy is crucially dependent on the country's ability to import needed raw materials and spare parts in order to fully utilize the existing productive potential. They are appreciative of the assistance provided by foreign creditors and aid donors thus far. However, to sustain their adjustment effort, they are calling on private and official aid donors and multilateral institutions to provide them with timely financial assistance sufficient to enable them to finance adequately their import program. Thanks to such support, a sound rate of economic growth can be achieved and the debt servicing capability of the country substantially improved.

Mr. Flamant commented that three years previously, Madagascar had been considered a country with a poor track record in its adjustment efforts under programs supported by the Fund. Since that time, however, the authorities had embarked on a complete reversal of economic and financial policies under successive Fund-supported programs. Those programs had been successful and had started to bear fruit, as described in the staff paper. The new standby arrangement, which he supported, built upon the results already achieved, with strong emphasis on supply-oriented policies. It was cause for regret, however, that the severe financial constraints facing the Malagasy economy would not allow for a growth rate higher than 3 percent in 1985, which would barely be sufficient to maintain per capita income.

The results achieved under the past program were impressive, Mr. Flamant remarked. On the fiscal side, the budget deficit had been brought under control through a mix of revenue-raising and expenditure-cutting measures. The containment of the wage bill was particularly noteworthy--and reflected the commitment of the authorities to the adjustment effort--as it had entailed a further decline in the purchasing power of civil servants. The increase in total revenue had exceeded the increase in current expenditure, thereby contributing to the steady growth in gross domestic savings from 4.8 percent of GDP in 1982 to a projected level of 9.2 percent in 1985. Fiscal discipline had played an important role in helping to curb monetary expansion, which in turn had had a favorable influence on the deceleration of inflation. The consumer price index had increased by 10 percent in 1984, instead of 20 percent as envisaged in the program, despite the impact of the flexible exchange rate policy being pursued by the authorities.

Progress had also been achieved in the external sector, Mr. Flamant continued, with a reduction in the current account deficit, the cash repayment of unconsolidated arrears, and a sizable increase in net central bank reserves. But that improvement was to some extent the result of the severe constraint on imports, which totaled SDR 15 million less than expected under the program. The inadequacy of the import program was a major factor behind the 1.8 percent real growth achieved in 1984, despite the supply-oriented measures implemented by the authorities. Those measures could have triggered a firmer supply response, and therefore a higher level of exports, if more financing had been available. That development justified the reservations expressed by his chair at the time of the approval of the previous program (EBM/83/179, 12/21/83) about the insufficient amount of Fund support and external financing.

The amount of the proposed stand-by arrangement--45 percent of quota compared with 50 percent under the previous stand-by arrangement--was clearly out of line with the strength of the adjustment effort as well as with the magnitude of the balance of payments need, which remained the two basic criteria for determining the level of Fund support, Mr. Flamant commented. At a time when the balance of payments remained under great strain and when creditors and donors were being asked to continue their support, it was discouraging to observe that the present stand-by arrangement would translate into a net repayment to the Fund of the order of SDR 5 million. Taking into account about SDR 11.5 million in charges, there would be, during the period covered by the program, a net transfer of resources to the Fund of about SDR 17 million, which corresponded almost exactly to the annual amount of balance of payments assistance provided by France to Madagascar over recent years. Although the inclusion of charges was debatable, the fact remained that the Fund was reducing its exposure while donors and creditors were being asked to increase theirs. That development was all the more regrettable because Madagascar's program for 1984-85 was clearly a strong and comprehensive one that maintained the momentum of demand restraint and broadened the range of supply-oriented measures, notably the continued deceleration in the increase of public employment, the small growth of net credit to the Government by about 12 percent in real terms--allowing increased credit to the private sector--and the decontrol of almost all interest rates.

The measures that had been taken were mutually reinforcing and would buttress the supply-oriented actions, Mr. Flamant observed. They included the continuation of the deregulation of industrial prices, in the wake of an industrial credit that had been approved by the World Bank with some delays; the start of a badly needed program to rehabilitate public enterprises as well as the commercial banks; and the increase, in real terms, of almost all producer prices when those prices were not fixed by market forces--which was the case for most commodities, including rice--demonstrating that the internal terms of trade had shifted in favor of the productive sector. Although such a pricing policy might be harmful to urban citizens in the short run, it was the only viable policy in the medium and long run. However, one major problem could hamper the success of that policy: if basic consumer goods were not available to the rural population in exchange for higher incomes, the supply response could be short-lived.

The program did not allow for larger imports of raw materials and spare parts for the productive sector along with larger imports of consumer goods, Mr. Flamant said. Although import policy was the only weak point in the program, it was an important one, making the decision to reduce the amount of access from 50 percent under the previous program to 45 percent under the present program all the more regrettable. The argument of the cost of Fund resources did not apply in the present case, as a marginal increase in the availability of resources would have a high marginal rate of return in foreign exchange, which would make it easier, rather than harder, to repay the Fund. With that proviso on the amount of the arrangement, he approved the proposed decisions.

Mr. Ismael remarked that Madagascar's progress in implementing its adjustment measures, particularly under the 1983-84 Fund-supported program, was encouraging. However, the economy continued to confront a number of serious problems that posed a challenge to the next phase of the adjustment effort. First, the rate of economic growth had been inadequate to prevent a continuous slide in per capita income and living standards in the past few years. Second, despite the progress achieved in restraining domestic demand and increasing domestic savings, thereby reducing the resource gap, high debt service obligations would continue to impose severe constraints on the balance of payments.

Viewed from that perspective, he agreed with the staff that the strategy to be adopted in the proposed program, which focused on production incentives through the increased role of market forces in determining prices and a shift in relative prices toward productive and tradable sectors, seemed to be well placed, Mr. Ismael continued. Steady progress in implementing the structural policies together with continued restraint on domestic demand were essential to enhance efficiency in resource allocation, to promote domestic savings, and to encourage exports.

Among specific aspects of the new program, recent measures to liberalize prices of some agricultural and industrial products at closer to market-determined levels were encouraging, Mr. Ismael said. It was noteworthy that despite those measures, inflation performance had improved markedly. Those developments were proof that price liberalization, if accompanied by appropriate demand- and supply-side policies, together with more flexible exchange rate management, was not likely to result in a disproportionately higher inflation rate. That was not to deny, however, the immediate once-for-all impact of such liberalization on prices. He encouraged the authorities to continue to implement price liberalization measures.

The further reduction in the fiscal deficit to 4.7 percent of GDP for 1985 was welcome, Mr. Ismael remarked. The 22 percent increase budgeted for investment expenditure, which was the first real increase since 1980, could be justified in terms of the longer-term prospects for the economy. The soundness of the investment program should, however, be ensured by soliciting the World Bank's assistance. On the revenue side, efforts had been made to improve the tax base and to reinforce tax administration. No additional tax measures were contemplated in the face of the steady decline in real per capita income and the structural changes transpiring in the economy. In view of the relatively small proportion of government tax revenue to total GDP, some tax measures, particularly in the realm of income tax, were justified even under the present circumstances. In addition, a somewhat higher revenue target was both feasible and desirable to strengthen public sector finances.

The faster than expected decline in the inflation rate had resulted in a substantial increase in the real money balance in 1984, Mr. Ismael observed. To minimize its expansionary impact on domestic demand, some tightening of monetary policy was therefore welcome. Given the lower bank financing required by the government sector, credit to the private sector would be maintained at the previous year's level. It was also encouraging that the substantial decline in the inflation rate had made all interest rates significantly positive in real terms, which had provided a valuable opportunity for the Government to eliminate administrative controls on virtually all lending and deposit interest rates, thereby inducing competition among banks.

Developments in the external capital account in 1984 were less favorable than in the previous year, with gross disbursements well below the program target and a negative net capital inflow, Mr. Ismael said. In view of the need to increase imports under the new program and the continuing high debt service obligations in 1985, serious efforts would be needed to ensure an adequate flow of resources so as not to jeopardize the achievement of the program's objectives. Meanwhile, the policy currently followed by the authorities of limiting the issuance of import licenses to about 70 percent of the original import program pending the conclusion of the Paris Club meeting on Madagascar's debt rescheduling request was commendable.

He was impressed by the readiness of the Malagasy authorities to match any shortfall in foreign financing with a proportional cut in imports to ensure the achievement of the program's objectives, Mr. Ismael commented. Under those circumstances, approval of the request for a stand-by arrangement could be given notwithstanding the uncertainty surrounding the filling of the financing gap, and he supported the proposed decisions.

Mr. Joyce stated that he was in general agreement with the staff's analysis and with the objectives of the Malagasy program. Under the previous stand-by arrangements with the Fund, fiscal and external deficits had been greatly reduced, exports as well as domestic savings had grown, and an increasing share of domestic credit had been made available to the private sector for productive investment. Domestic arrears had been eliminated, and considerable gains had been made in reducing external arrears.

Nevertheless, Mr. Joyce continued, imbalances in the economy, although reduced, continued to exist, especially with regard to the balance of payments over the medium term. Despite economic growth of close to 2 percent in 1984, per capita income continued to decline because of the high rate of population growth. If real per capita income growth and balance of payments stability were to be restored over the medium term--which was essential--and if the support of creditors and donors was to be maintained, there was no choice but to continue vigorously to pursue the adjustment process.

He supported the program's emphasis on supply-side adjustment measures and on pricing and marketing liberalization, Mr. Joyce commented. Prudent fiscal and monetary policies would have to be maintained; however, appropriate macroeconomic policies were a necessary but not sufficient condition for a sustainable recovery and for stabilizing the external sector. Increases in key agricultural producer prices, in particular the planned increase in the price of rice, as well as further decontrol of industrial prices were essential to the expansion of the economy's productive capacity. The goal of self-sufficiency in rice production by 1988 was ambitious but necessary if the economy was to move forward. Madagascar must intensify its efforts to restructure its economy and build a more export-oriented productive base.

While he could accept the staff's view that little additional fiscal adjustment was warranted at present, he would have preferred more immediate steps to put parastatals facing financial problems on solid ground, Mr. Joyce remarked. The lifting of some price controls was welcome, as was the test rehabilitation program for a limited number of public enterprises in 1985, but those measures were not likely to be sufficient to stanch the drain of the public enterprises on the budget. He hoped that more comprehensive measures would be worked out during the first review under the arrangement, since by that time the Government would be able to describe the actions it proposed to take in the light of the results of the banking system audit.

With regard to monetary policy, Mr. Joyce said that he welcomed the restraint exercised over credit growth, the shift in credit in favor of the private sector, and the steps to remove controls over interest rates; those measures were positive and appropriate.

He was encouraged by the authorities' commitment to a flexible exchange rate policy and by recent efforts to reduce arrears and strengthen exports, Mr. Joyce said. Nonetheless, debt rescheduling and concessional assistance would be needed for many years to come. A strong and unwavering commitment to adjustment would no doubt make a favorable impression on the Paris Club and other creditors.

The World Bank must continue to play a major role in helping to finance and guide the structural adjustment process, and to provide leadership in marshaling donor resources, Mr. Joyce observed. Clearly the Fund and the Bank had common purposes in Madagascar and should continue to work closely together.

The proposed arrangement was an example of prolonged use of Fund resources, Mr. Joyce remarked, but significant progress had been made under the four successive programs to date. The amount involved in the proposed stand-by arrangement was comparatively small, given the likely need for continued Fund involvement. Madagascar had eliminated its domestic arrears and had remained current in its repayments to the Fund. For those reasons he did not hesitate to support the request for a stand-by arrangement.

Mr. Goos noted that Madagascar's continuing adjustment effort had already led to encouraging results in virtually all sectors of the economy. Those impressive results clearly showed that the adjustment course chosen was in the right direction and therefore should be adhered to in the years ahead. Accordingly, he welcomed the continued and increased emphasis of the new program on structural measures combined with a generally appropriate degree of demand management restraint. He could therefore support the requested stand-by arrangement.

The reduction in domestic and external imbalances achieved so far could only be considered an intermediate step on the long path toward achieving a viable economic position, Mr. Goos commented. That view was borne out by the medium-term outlook in the staff paper, which highlighted the continuing precarious external situation of the country. In addition, the improvements under the past adjustment program were the result to some extent of exceptional developments. Thus, overall economic growth and the external current account had been supported by an unintended shortfall in imports caused by lower than expected aid disbursements. Similarly, the improvement in the fiscal position in 1984 had been helped by a one-time shift in the income tax collection system, the beneficial effects of which could not be expected to recur.

Those factors underlined the importance of maintaining, and whenever possible increasing, the adjustment effort, Mr. Goos stated. Notwithstanding the improvements achieved so far, there remained considerable scope for further action. He encouraged the authorities to accelerate pricing and marketing liberalization measures and to secure remunerative producer prices in agriculture as a means of further stimulating production and exports. Furthermore, he recommended a somewhat more vigorous approach to rehabilitating public enterprises, perhaps in a more comprehensive framework along the lines of the three-stage strategy for reforming the banking system. In any event, timely results would be beneficial--in particular a faster reduction of the public sector deficit than envisaged under the program, which did not appear overly ambitious in that respect.

Given the strong compression of imports over the past years, further import reductions would probably not be a meaningful instrument for reducing external imbalances without impairing the productive base of the economy, Mr. Goos remarked. He therefore agreed with the staff that increased emphasis should be given to strengthening the supply side of the economy, particularly export performance. Equally important was the staff's recommendation to ensure that scarce foreign exchange resources were used for imports that would generate maximum benefit to the economy. However, he wondered whether the need to generate more domestic resources had been given sufficient attention. He was concerned that the program did not aim at a further reduction of the inflation rate, which, at 10 percent, appeared high. Furthermore, he was not convinced that the reduction of the rate on individual deposits of 6-12 months would be appropriate. Apparently the decision to implement that reduction had been influenced by the lack of responsiveness of individual deposits to the increase of that interest rate in mid-1984. However, the higher interest rate had been effective only for a short period of time so that significant increases in individual deposits could not be expected. Furthermore, the increased deposit rate had been only moderately positive in real terms in the second half of 1984. He therefore recommended that the decision to reduce the deposit rate be reconsidered, and he would be grateful for any comment by the staff or Mr. Alfidja on that point.

He congratulated the authorities for their courageous and comprehensive commitments under the requested stand-by arrangement, and he welcomed the prior actions that they had taken, Mr. Goos said. Those commitments deserved the Fund's financial support, particularly given the positive achievements over the past years. However, as the present request was for the fifth consecutive stand-by arrangement, Madagascar clearly belonged to the category of prolonged user of Fund resources, which gave rise to well-known concerns. He welcomed the reduction of the Fund's financial exposure under the new arrangement, a development that should be continued in the years ahead. He did not advocate a rash withdrawal of Fund support in a country with such an impressive adjustment record, but he hoped that a successful implementation of the present stand-by arrangement would greatly reduce the need for future Fund financing. Continued financing of structural adjustment measures with Fund resources would be inappropriate. Therefore he strongly underlined the staff's view that the World Bank and other development institutions should play an increasing role in supporting Madagascar's adjustment process.

Mr. Zecchini said that Madagascar was implementing a sound and consistent adjustment effort, and the policies put in place pursuant to the Fund's advice were producing results. Nevertheless, the economic and financial situation of the country remained difficult, mainly due to past developments. In those circumstances, Madagascar merited steady financial assistance from the international community on a medium-term to long-term basis, and he therefore supported the proposed stand-by arrangement. He was also prepared to support the temporary approval of exchange restrictions, subject to some reservations.

He agreed with the staff regarding the importance of the stimulus arising from price flexibility in achieving a substantial revitalization of production and market supplies of many agricultural crops, Mr. Zecchini commented. The supply of rice, for example, was believed to have increased in 1984 despite the loss of about 6 percent of output. At the same time, however, consumer price inflation had been moderate, at about 10 percent compared with nearly double that amount in 1983. Were consumer and producer prices supposed to follow a different path in the Malagasy economy in the coming years? On the one hand, price liberalization aimed at stimulating output by inducing appreciable increases in producer prices. On the other hand, the dynamism of consumer prices was expected to be moderate. In that case, to what extent was the reduction in the profits from market intermediation to be expected? Unfortunately, information on those points had not been provided by the staff although it was essential for the evaluation of the impact of price liberalization.

Clarification was also needed with regard to developments in imports in relation to financial constraints, Mr. Zecchini remarked. Madagascar constituted an interesting example of an economy subject to pervasive rationing: imports depended on the availability of finance, while production and exports in turn depended, presumably, on imports. In such circumstances, it was conceivable that greater availability of external finance, such as envisaged for 1985, would automatically be translated into additional imports of essential primary and intermediate goods, which in turn would permit higher levels of production and export flows. The balance of payments projections for 1985 indicated, however, that the increased availability of finance in the form of public transfers and other net long-term flows would not be matched by a corresponding expansion of imports but would instead result in a substantial improvement in the balance of payments. It was clear that a major role in those developments would be played by the licensing scheme for imports, which represented a temporary intensification of exchange restrictions for which the authorities were requesting approval by the Executive Board. What was the justification for restricting the growth of imports and therefore, presumably, production and exports, even in the face of an expected increase in the availability of finance?

Import levels would be adjusted to the availability of finance, Mr. Zecchini continued, and as the financing gap represented approximately one third of programmed imports for 1985, the impact on imports might be great depending on the amount of available financing. Did not the approval of a program when a large financing gap existed represent a departure from past experience? Furthermore, was the intensification of exchange restrictions to be interpreted as a prudent measure that would be relaxed as soon as the financing picture for 1985 became clearer? Only in that case would approval by the Executive Board be justified. Could the staff or Mr. Alfidja provide more detailed information on the use of the import-licensing scheme during the program period?

On fiscal policy, Mr. Zecchini remarked, he wondered whether more ambitious targets might not have been considered for 1985, as the overall fiscal deficit with respect to GDP was expected to remain at approximately its 1984 level.

The Malagasy economy would continue to need steady financial assistance on concessional terms in the medium to long term, even if the most favorable circumstances and the most appropriate policies should materialize, Mr. Zecchini concluded. Given the authorities' strong record of collaboration with the Fund, it would have been appropriate to set the rescheduling of Madagascar's external debt in a longer-run framework so as to reduce the year-by-year uncertainties concerning the availability of finance and to allow for a smoother development of the adjustment effort in the medium term.

Mr. Clark said that he welcomed the progress made by Madagascar under the most recent arrangement with the Fund. That progress was exemplified by a further reduction in the fiscal deficit, the easing of inflation, and the resumption of faster, although still modest, GDP growth. Those developments were particularly striking in view of the external disruption to which the economy had been subject in 1984.

He supported the authorities' decision to maintain a flexible approach to import growth until the outcome of rescheduling discussions was clear, Mr. Clark continued. There seemed to be some difference of view between the authorities and the staff on the rate of growth of imports needed to sustain the projected 3 percent rise in GDP; he would appreciate more information from the staff on that point. He shared some of Mr. Zecchini's concerns about approval of the stand-by program without firm financing in prospect. Another area of concern was the projected falloff in direct tax revenue, not only from the unusually high figure for 1984, which reflected a shift to a pay-as-you-earn system, but from figures for earlier years as well. He would be interested to know more about that projection.

Under the program the rate of inflation was projected to remain at about 10 percent, the same as in 1984, Mr. Clark remarked. He wondered why a more ambitious target had not been adopted, as the 1984 figure had presumably been boosted by the 15 percent devaluation in March and by the domestic price adjustments introduced during the year. With those factors no longer operating, or if so with less force, a further decline in inflation might have been expected. In that connection, he wondered whether a slightly tighter target for domestic credit expansion might not have put extra downward pressure on price increases.

The phasing of purchases under the stand-by arrangement seemed unusual, although he had no particular difficulty with the provision for six drawings, Mr. Clark commented. He invited the staff to comment on why performance criteria had been set only as far as end-September.

With regard to the medium-term outlook, there was no doubt, in terms of current account deficits, debt service ratios, and so on, that Madagascar faced a long haul, Mr. Clark observed. Moreover, even if the assumed growth of export revenue was achieved, given the composition of Madagascar's exports there were likely to be fluctuations that might increase pressures for further adjustment. There seemed little doubt that the Fund would need to maintain its involvement, and he stressed the major role also to be played by the World Bank. In view of the economic prospects, the modest level of access proposed for the stand-by arrangement was appropriate. Madagascar had taken significant steps toward setting the economy on a viable track, and he supported the proposed decisions.

Mr. Suraisry said that he was in broad agreement with the staff analysis and conclusions and could therefore support the proposed decisions. In recent years the Malagasy authorities, with the support of the Fund, had made commendable progress in reducing domestic and external imbalances. Performance under the 1983-84 stand-by arrangement had been particularly encouraging. The fiscal deficit had been greatly reduced, and the current account of the balance of payments had improved. Domestic inflation had moderated, and real GDP had begun to grow at a moderate pace. The stage was set for a steady recovery. As the authorities recognized, however, continued structural adjustment was needed to sustain real growth and to improve the economy's debt servicing capacity. He therefore welcomed the present program's focus on strengthening structural adjustment, without relaxing demand management.

More specifically, Mr. Suraisry continued, he supported the authorities' intention to build on their earlier successful efforts to expand production and exports. The steps being taken to adjust domestic prices further and to improve marketing arrangements, together with the continued flexible exchange rate policy, were appropriate and deserved Fund support. He noted with satisfaction the active involvement of the World Bank in developing the Malagasy economy. However, although a structural adjustment loan was under consideration by the Bank, it would not be disbursed before fiscal year 1987. That loan would be particularly valuable and more effective at an earlier date, and it could support the authorities' plans to improve production incentives and realign cost-price relations in a manner consistent with efficient resource allocation. Like Mr. Joyce, he believed that the World Bank could play a larger role in promoting economic development and adjustment in Madagascar.

On the fiscal side of the program, the authorities should maintain their anti-inflationary stance by keeping current expenditures under tight control, Mr. Suraisry remarked. The rehabilitation of public enterprises should also be continued in order to raise the level of public sector savings.

Monetary policy seemed consistent with noninflationary growth, Mr. Suraisry observed. For that purpose, the expansion in total credit in 1985 would be smaller than in the previous year. It was, however, encouraging that within that total, credit would be distributed in favor of the private sector. He agreed with the staff that that measure was consistent with policies aimed at expanding the role of the private sector in economic activity.

The current account and overall balance of payments positions were expected to show continued improvement, Mr. Suraisry noted. However, owing to the heavy debt service burden, the balance of payments was likely to remain under pressure for some time to come. That outlook underlined the importance of continued measures to promote exports over the medium term. Madagascar also needed to maintain a level of imports consistent with sustained growth; but since reserves were inadequate and arrears had built up, an adequate flow of imports would depend largely on the availability of foreign financing. In that connection, it was encouraging that Madagascar was continuing to pursue appropriate adjustment policies and had benefited from debt rescheduling by the Paris Club. Timely assistance from the World Bank in support of the authorities' structural adjustment efforts could also help to improve the medium-term economic and financial outlook.

Mr. Salehkhou noted that since the previous Article IV consultation (EBM/84/147, 10/9/84), Madagascar's economic and financial performance had continued to be largely satisfactory and within the targets of the recently expired Fund-supported adjustment program. Besides significant progress in reducing fiscal and external imbalances, containing inflationary pressures, resuming domestic economic growth--although at a modest rate--and making gradual net reductions in external arrears, there had also been a welcome improvement in the authorities' ability to monitor financial developments and to implement timely corrective measures--an improvement that had been instrumental in ensuring the success of the 1983-84 adjustment program. It should also be noted that progress in containing financial imbalances would have been more significant without the impact of substantially higher interest payments on external debt.

Despite the progress achieved under successive Fund arrangements, however, Madagascar's economic policies and prospects remained largely constrained by sizable outstanding external indebtedness and by structural imbalances that could be corrected only over the medium term, Mr. Salehkhou continued. Furthermore, domestic and external adjustment had been accompanied by a substantial curtailment of imports, which was only partly due to the authorities' attempts to eliminate unproductive public investment and which seemed to have adversely affected the economy's productive capacity.

The emphasis in the proposed stand-by arrangement on the need to strengthen real economic growth while continuing structural adjustment efforts was welcome, Mr. Salehkhou said. The program aimed at a further reduction in fiscal and balance of payments deficits, consolidation of the progress achieved in controlling inflation parallel to an acceleration of price decontrol and the introduction of import liberalization, full implementation of the 1985 import program to achieve the real GDP growth objective, an additional net cash reduction of external arrears, and a modest increase in Madagascar's net official reserves.

He supported the broad objectives of the proposed adjustment program as a generally appropriate follow-up to earlier stand-by arrangements with Madagascar, Mr. Salehkhou stated. However, the level of access under the proposed stand-by arrangement gave cause for concern. Excluding charges, and assuming that all expected purchases were realized, there would be an actual net transfer of resources to the Fund by the end of the program, as holdings of Malagasy currency subject to repurchase would decline from 227.3 percent of quota as of February 1985 to 212.9 percent. A net repayment to the Fund seemed hardly justified at the present stage in view of the level of the member's overall use of Fund resources under credit tranche policies, the acceleration of adjustment required under the proposed stand-by arrangement, the introduction of a degree of import liberalization, and Madagascar's recognized need for sizable inflows of external concessional assistance from both bilateral and multilateral sources. The proposed level of access seemed to be in line with the staff's insistence on a broader role for the World Bank in Madagascar, as structural changes would be crucial to strengthen the gains achieved in the past two years. However, the economy's major constraints over the medium term were mainly related to balance of payments disequilibrium and the burden of external debt. Thus, an appropriate level of Fund assistance would continue to be essential to sustain and gather support for the authorities' efforts.

The prospects for the realization of the 1985 import program and the modest real growth objectives were dependent not only on improved procedures for disbursement of external loans but also on the outcome of rescheduling negotiations with Madagascar's foreign creditors, Mr. Salehkhou remarked. It was therefore essential for the full implementation of the proposed program that imaginative and forward-looking debt restructuring arrangements should be promptly adopted. In that connection, the concern of the authorities was reflected in both their letter of intent and Mr. Alfidja's statement.

The financial difficulties faced by various public enterprises could not be dealt with through price decontrol alone, Mr. Salehkhou observed. A detailed rehabilitation plan, including a precise timetable of measures to be taken, would also be required to improve those enterprises' financial positions and reduce acute liquidity pressures that threatened the stability of the banking system.

He supported the proposed decisions, although the adequacy of the level of access gave cause for concern, Mr. Salehkhou concluded.

Mr. Abdallah stated that he was in broad agreement with the staff appraisal. However, he shared the concern that had been expressed by Executive Directors regarding the level of access being proposed for Madagascar under the proposed arrangement. Madagascar had made strong adjustment efforts and had met all performance criteria under the recently expired arrangement and had even surpassed some of the requirements. The proposed arrangement required Madagascar to continue those efforts and to reinforce further some of the measures. Despite the member's good record, the assistance being granted to Madagascar was such that at the end of the program the country would be a net payer to the Fund rather than a net user of resources. That situation was incongruous, particularly as the country was facing a large financing gap that had yet to be filled.

The Malagasy authorities had made a strong plea to creditors and the donor community, Mr. Abdallah pointed out. The country faced difficult medium-term prospects for its balance of payments, largely on account of its high debt burden. Madagascar was prone to natural hazards, including cyclones, one of which had struck the island in April 1984. The country's difficult circumstances and the strength of its adjustment efforts qualified it for donor support under any criteria. He therefore hoped that the forthcoming Paris Club negotiations would be conducted in a spirit of understanding and helpfulness, and would result in substantial net flows of resources that would allow the country to maintain the modest growth that had been realized in 1984 after some years of decline. The World Bank also had a clear role to play in resource mobilization and policy guidance. He endorsed the proposed decisions and supported approval of the temporary intensification of existing exchange restrictions.

Mr. Jayawardena stated that he was in broad agreement with the staff appraisal and supported the proposed decisions. He commended the authorities for successfully completing the previous stand-by arrangement and for making progress during the recent period of adjustment under several Fund programs. Madagascar had approached the Fund with severe external debt problems, but the authorities had persevered, first with demand management policies and later with supply-oriented policies, despite unfortunate natural disasters. In fact, perhaps Madagascar could have reaped greater benefits from the more adequate financing available under an extended arrangement. Adjustment had been further affected by the slow disbursement of external assistance.

The authorities' admirable success in resuming growth and containing inflation was largely due to the liberalization of the economy and to prudent fiscal, monetary, and exchange rate policies, Mr. Jayawardena said. He supported the intention of the authorities to pursue that path in the new program. Because of the welcome elimination of administrative and procedural delays, a high utilization of external resources was expected. Almost the entire balance of payments current account deficit reflected imports financed by capital inflows. The liberalization of the financial markets and the deregulation of the agricultural and industrial sectors were commendable, and he fully endorsed the flexible exchange rate policy.

Like other Directors, however, he was concerned that there would be a net inflow of resources to the Fund during the proposed program, Mr. Jayawardena continued. While he did not wish to underplay the significance of Fund support so far, more liberal support by the Fund--as well as the Bank and the donor community--would have greatly helped Madagascar to undertake a stronger path of adjustment which might have avoided the need for a fifth successive stand-by arrangement. Lingering price controls, regulated markets, import controls, and export retention schemes reflected the need for further progress. Again, an extended arrangement might have enabled the authorities to make the appropriate policy changes.

He could not go along with the view that Madagascar should turn to the World Bank, Mr. Jayawardena remarked. The necessary macroeconomic structural changes were best dealt with under Fund guidance, although the Bank was better equipped to address the rehabilitation and investment needs of the economy and to catalyze donor support for that purpose.

Like other speakers, he wondered why six drawings were planned under the proposed stand-by arrangement, Mr. Jayawardena said. When the Executive Board had discussed the relationship between performance criteria and the phasing of purchases under Fund arrangements (EBM/85/38, 3/8/85), the Managing Director had assured Executive Directors that any departure from accepted practice would be flagged for the attention of the Board, with an explanation, so that policy changes initiated at management level would not go unnoticed. It would be useful to know whether the staff considered the present matter too inconsequential for specific attention.

On another matter, Mr. Jayawardena agreed with the staff that deposit rates should be liberalized because of the need to ensure an increase in domestic financial savings. Table 5 of the staff report indicated that quasi-money was expected to increase in 1985 by less than FMG 2 billion, compared with an increase of FMG 7 billion in 1984 and FMG 6 billion in 1983. He invited the staff to explain why the elimination of interest rate control was considered desirable if the effect on quasi-money was not significant.

Ms. Bush noted that Madagascar's performance under the previous stand-by arrangement clearly indicated its commitment to the adjustment effort; all performance criteria had been met and several targets had been surpassed. Higher than expected economic growth, a reduction of the fiscal deficit to 4.8 percent of GDP, and a lower than expected current account deficit and inflation rate were particularly welcome developments. Perhaps the inflation outcome was useful evidence that devaluation need not necessarily lead to escalating inflation; in fact, it could lead to an increased domestic supply of import substitutes, thus easing price pressures. Further liberalization of the rice sector had also been a positive factor.

The new program appeared designed to consolidate the gains made under the previous program, with particular emphasis on enhancing producer incentives and broadening the role of the market, Ms. Bush commented.

While recognizing that significant progress had been made and understanding the financial constraints that impeded complete liberalization, she remained discouraged by the remaining wide control over pricing, production, and marketing in Madagascar, and she urged the authorities to hasten further liberalization, even beyond that included under the new arrangement.

She welcomed the emphasis on the production of import substitutes, such as rice, where Madagascar could be competitive, Ms. Bush said. Elimination of the ceiling on the consumer price of rice, increases in producer prices, and wider use of the option system should generate more rational consumer and producer decision making. Increases in producer prices for cotton and black pepper, where export prospects were good, as well as for coffee, were also welcome. She invited the staff to comment on the present relationship between world market prices for those commodities and producer prices in Madagascar.

The fiscal adjustment programmed for 1985 might not be dramatic, compared with the 1984 outcome, yet the various elements--such as limitations on salary and employment increases, a more carefully planned investment budget, and the rehabilitation of some public enterprises--appeared appropriate, Ms. Bush remarked. However, to attain a sustainable budgetary position in the medium term while providing adequate domestic resources for investment, it was likely that further restraint on current government expenditures would be necessary.

The most significant step being taken to rehabilitate the public enterprises was the gradual elimination of price controls, Ms. Bush observed. That process should be accelerated, and privatization should be more widely considered as an option.

Monetary policy appeared adequately tight overall, with limited increases in credit to the Government and liberal increases in credit to the private sector, Ms. Bush commented. She welcomed the recent elimination of controls on interest rates and noted that interest rates remained positive in real terms.

The flexible exchange rate policy continued to work well, Ms. Bush considered, with real effective depreciation stimulating production of exports and import substitutes. Export taxes on nontraditional exports had been eliminated, which should stimulate production. As the domestic tax base was broadened, the authorities should consider reducing taxes on traditional exports as well. The implementation of a gradual import liberalization scheme was commendable.

The staff report was somewhat vague about how the financing gap of SDR 115 million would be closed, Ms. Bush said, and she shared the concerns of Mr. Zecchini and Mr. Clark. It would have been helpful to include in the staff tables a breakdown of reschedulable debt, so that creditor governments could calculate alternative scenarios. Furthermore, the import level would supposedly be adjusted to accommodate financing. But, the authorities' expectations regarding import levels could be difficult to scale back if less than expected debt relief was forthcoming. The impact on economic activity of such a scaling back would also cause concern. In many other cases, the result had been an accumulation of external arrears instead of a reduction in imports. She would be interested in information on how the gap would be filled.

As Madagascar had been a prolonged user of Fund resources, like Mr. Joyce and Mr. Goos she regarded the access provided under the stand-by arrangement as appropriate, Ms. Bush stated. Madagascar's present situation, with financial imbalances greatly reduced since 1980 and with a greater need for structural reforms, led her to suggest that perhaps the World Bank and other development institutions should play a leading role in formulating and financing the adjustment effort. Concessional assistance, as opposed to shorter-term balance of payments support, would be more appropriate for meeting the financing requirements projected for the remainder of the decade. In conclusion, she supported the proposed decisions.

Mr. Rye stated that he agreed with the staff appraisal and supported the proposed decisions. The 1985-86 adjustment program focused on production incentives and pricing and marketing liberalization. Those objectives were laudable and welcome, but he wondered about the role of the World Bank in those structural issues. He invited the staff to provide information, especially in regard to the important rice sector.

In addition, he had some reservations about the approach to public enterprises, Mr. Rye continued. In particular, he would have liked to see a more definite rehabilitation timetable, although he appreciated the expression of intent. The discussion in the staff paper was somewhat general and did not give a clear impression of the direction of reform, in marked contrast to the discussion on the banking system, which was well defined. He invited the staff to comment.

The balance of payments position was expected to remain tight through the medium term, Mr. Rye noted, principally because of the country's heavy debt service burden. The authorities had expressed their intention to adjust import levels according to aid and debt relief received, but it seemed that further import cuts would threaten the sustainability of even minimal rises in economic activity that would enable real income levels to be maintained. That point underlined the crucial need for an appropriate response by donors and creditors to Madagascar's financing needs.

Mr. Polak said that he supported the program under the proposed stand-by arrangement. Table 1 of the staff paper seemed to indicate, erroneously, that there were only four purchases projected during the period of the arrangement. When more purchases were scheduled than for the four quarters of the year, it would be desirable to illustrate that fact explicitly in the table.

The Deputy Director of the African Department pointed out that, with regard to access under the proposed stand-by arrangement, although total Fund credit outstanding would seem to decline from SDR 146 million to SDR 141 million, or a reduction of about 8 percent of quota, the use of Fund credit outstanding under tranche policies, as shown in Table 1 of the staff paper, would in fact increase by about 10.5 percent of quota over the program period. The reduction would result from repayments under the compensatory financing facility, and he considered it appropriate to distinguish between compensatory financing and tranche policy drawings.

The six purchases under the stand-by arrangement were consistent with the operational guidelines on the relationship between performance criteria and phasing of purchases under Fund arrangements agreed at EBM/85/38 (3/8/85), the Deputy Director continued, and therefore did not constitute a change in Fund practice. The six drawings were related to the period of the stand-by arrangement--from April 1985 to April 1986--rather than December 1985 to December 1986. The phasing had also been governed by the two required reviews and had been constrained by the guideline that the last drawing "would not be earlier than two months before the end of the arrangement." The drawings were scheduled to take place, first, following approval of the stand-by arrangement by the Board; second, subject to end-April performance criteria being met; third, upon completion of the review and satisfaction of end-June performance criteria; fourth, subject to meeting end-September performance criteria; fifth, after completion of the review and meeting end-December criteria; and sixth, one month before expiration of the program.

Indicative targets had been set through end-December partly because of the uncertainty relating to the financing gap, the Deputy Director explained. The staff had wanted the entire financing package to be fully put in place before ceilings were established for 1985 as a whole. An important factor was action by the Paris Club that would affect the size of Madagascar's import program and thereby government revenue from import duties and other areas. Ceilings should be established in the course of the August review when a financing package would be in place.

There was, in fact, not much uncertainty regarding the financing package that affected the decision being considered by the Executive Board, particularly taking into account the rescheduling terms accorded Madagascar by the Paris Club for the past two or three years, the Deputy Director pointed out. The staff had assumed that the Paris Club would accord terms comparable to the so-called Paris Club III terms granted in 1984; under those circumstances, SDR 340 million of imports would be fully covered. However, following informal discussions with the Paris Club Secretariat, the staff had decided that it should not indicate to the Board that the Paris Club was expected to accord the same terms as in previous reschedulings. The most pessimistic option was that Paris Club I terms would be accorded whereby only those debts falling due that had not been previously rescheduled would be rescheduled on terms comparable to the earlier exercise. The most optimistic option was the granting of terms more favorable than Paris Club III. The third option--Paris Club III terms--had been indicated in the staff report tables. Nevertheless, in the program, the authorities had not even assumed the granting of Paris Club III terms and were therefore implementing only 70 percent of the import program that had been envisaged. Taking into account the Paris Club options and their effect on the program, the staff believed it reasonable to propose to the Executive Board that the stand-by arrangement become effective as of the date of approval. The review in August would take into account the results of the Paris Club meeting in May, the status of the financing package, and the agreement with the authorities on the size of the import program.

Fixing the target for inflation at about the same rate as that achieved in the past year had been viewed as perhaps unduly timid by the staff who had suggested that a more restrictive credit policy might have been appropriate, the Deputy Director recalled. An inflation rate target below 10 percent was considered too ambitious at present for two reasons. First, the staff was not certain that the impact of the depreciation that had taken place had already worked into the economy. Second, during the second half of the year Madagascar's rice crop would come on the market and its volume would be important in determining the rate of inflation. In addition, for the first three or four months, price controls had been sufficiently tight that they did not quite reflect the possible underlying rate of inflation. Apart from the rate of inflation, the economy was beginning to suffer from a lack of liquidity. In the previous two years, money supply had been declining in absolute terms, and the increase in the velocity of circulation had surpassed the programmed level in 1984; for 1985 it was considered prudent to aim at a stable velocity of circulation. Even with the assumed rate of monetary expansion, it would not be surprising if the rate of inflation turned out to be lower than projected in the program, as figures received for January indicated a drop of about 2/10 of 1 percentage point.

The staff and the authorities agreed that an import program of approximately SDR 357 million was necessary to achieve the 3 percent growth rate target, the Deputy Director said. At present, however, that amount could not be financed and if the import program were reduced to approximately SDR 340 million, the rate of growth would be about 2.6 percent. The staff had indicated to the Consultative Group that if that amount of financial assistance were not forthcoming, the rate of growth might decline. Incidentally, all revenue estimates in the budget were based on imports amounting to SDR 340 million.

The staff agreed with the Directors who had commented that the parastatals were an important issue that called for a more comprehensive program of rehabilitation, the Deputy Director noted. The authorities also were aware of the situation and while initiating a test rehabilitation program they were also considering total reform of those enterprises. For that reason, instead of waiting to launch a comprehensive reform program covering a majority of state enterprises, the authorities were focusing on those few enterprises that posed an immediate threat to the banking system and placed a burden on the budget. The authorities planned to reform the state enterprises pari passu with the reform of the banking system. A World Bank industrial mission had just returned from Madagascar, and further appropriate developments were expected during the course of the year. A major problem of the parastatals was price controls; however, prices had been liberalized, and, under the World Bank program, some of the tariffs, particularly of public utilities, had been increased substantially so that the financial outcome of those parastatals should improve over the previous year.

The focus of the program had not been to determine whether decontrolled interest rates remained positive or negative, the Deputy Director explained, but rather to reorient the authorities toward credit and monetary policy that was free of centralized control. If a large number of interest rates could be freed and the banking system made competitive, the controlled interest rates--such as deposit rates--would automatically move in conjunction with the free rates. The program's emphasis on liberalization and flexibility did not necessarily mean that both actions should always lead to an upward movement in interest rates. While some control could be accepted, and those rates should remain positive, that positive margin need not continue to increase. To the extent that there was a decline in the rate of inflation, from 40 percent to about 10 percent, the authorities believed that the reduction in interest rates would justify that flexibility.

The authorities were attempting to generate to the extent possible a more significant increase in domestic resources, the Deputy Director said. The total amount of the current budgetary surplus would increase, and the staff was therefore expecting an increase in the savings rate from 8 percent to 9 percent in 1985. Once interest rates were moving freely and the budget was under control, there should be a continuous increase in domestic resources to finance domestic investment.

A question had been raised about the consistency of allowing a reduction in consumer prices together with a continued increase in producer prices and the impact on the profitability of state enterprises, the Deputy Director continued. In fact, the rate of inflation was declining, prices were being liberalized, and enterprises could cover their costs. The profitability of enterprises would enable them to finance their investment rather than go through the budget.

Demand management policies would have a substantial role to play in Madagascar's adjustment program, the Deputy Director observed. But that role was considerably limited if adjustment policies did not take account of the supply side. The staff, in conjunction with the World Bank, had indicated to the authorities the various areas where structural decisions would have to be made, notably the state enterprises, the banking system, the transport sector--which was a crucial bottleneck on which the World Bank was also working--the industrial sector, and the agricultural sector. The World Bank had considered a comprehensive structural loan three years previously, but had decided that a structural adjustment loan in 1987 would be a more efficient use of resources. That decision had been correct, and 1987 was not so distant in terms of the time horizon of the World Bank for that particular facility.

There were two reasons for the shortfall in aid disbursements in 1984, the Deputy Director of the African Department commented. First, the Aid Donors' meeting had not taken place until April 1984 and Board approval of the 1984-85 stand-by arrangement had been postponed for a couple of months; therefore only about eight months remained during which to disburse aid. To avoid that problem, the Consultative Group had met in November 1984 so that aid disbursement could take place throughout 1985. Second, certain procedural problems had arisen as the aid was being disbursed. The authorities had approached major donors bilaterally and had succeeded in obtaining a simplification of the disbursement procedures; in some cases the amounts had been placed in the country's account so that the funds could be drawn when the imports had been effected, resulting in only a short delay.

The staff representative from the Exchange and Trade Relations Department commented that, while total Fund credit outstanding would decrease during the period of the arrangement, as shown in Table 1 of the staff paper, there would in fact be a net increase in the use of resources under tranche policies by roughly 11 percent of quota. On the general question of access under tranche policies, the two principal criteria that governed access were, first, the country's balance of payments need taking into account other sources of financing; and second, the strength of the adjustment. The timing and extent of the expected improvement in the member's balance of payments, the amount of outstanding use of Fund credit, and the member's record in using Fund resources in the past were relevant factors in determining the case for Fund support and the amount involved. Madagascar's recent record had been good; on the other hand, the member would, despite the improvement achieved, have substantial financing gaps in its balance of payments over a number of years.

In the discussion on access limits for 1985 (EBM/84/134 and EBM/84/135, 9/5/84), Executive Directors had specifically addressed cases where the weakness of the member's balance of payments was such that it was questionable whether a sustainable position not requiring exceptional finance could be achieved over the medium term, and where the difficulties arose from the existing burden of debt service, the staff representative recalled. In such cases the Board recognized that the level of Fund financing would be limited; a principal objective of Fund support would be to maintain the confidence of the member's other creditors and donors so that the bulk of external assistance might normally be provided on appropriate terms from sources other than the Fund. Madagascar's balance of payments outlook and its large debt service payments clearly showed that it fell within that category; thus access to the Fund's resources under tranche policies had been limited to the amount proposed.

The phasing of six purchases under the stand-by arrangement had been decided according to the guidelines adopted by the Board at EBM/85/38 (3/8/85), the staff representative noted. Essentially, two considerations had been involved. First, the program referred to calendar year 1985, but for several reasons the Executive Board was discussing the stand-by arrangement only at the end of April. It was therefore necessary to ensure an early test date for performance criteria under the program, and it had been specified for end-April, which benefited the country by enabling it to make the first purchase on approval of the program and the second purchase without an unduly long lapse of time. Thereafter, performance criteria had been set for the normal quarterly periods. Second, if the last test date had been limited to December it would have breached the guideline approved by the Board whereby there should not be an excessive gap between the last performance test date and the end of the stand-by arrangement. For that reason an additional test date had been set for the end of February 1986, giving rise to six purchases under the stand-by arrangement.

He agreed with Mr. Jayawardena that at the time of the discussion at EBM/85/38, it had been noted that in the case of exceptional phasing arrangements there would be an explanation offered in the staff report; he regretted that that had not been done in the present case. He also agreed with Mr. Polak that Table 1 in the staff paper should have been set up in a way to make it clear that there would be six purchases and not, as one might perceive from the table, four.

Mr. Jayawardena noted that Executive Board Decision No. 7925-(85/38), adopted March 8, 1985, on the relationship between performance criteria and phasing of purchases stated in paragraph 4 that "there would be no fewer than four purchases during a 12-month period of the arrangement, five being the preferred course of action. The purchase dates would also be distributed as evenly as possible throughout the arrangement." There was no reference to six purchases nor to stand-by arrangements having to be on a calendar-year basis. In fact, the staff paper in discussing the number of purchases referred to the period of the arrangement. The decision of March 8 did not justify the addition of a performance test. The guidelines should be followed, and he suggested that the April 1985 performance review should be eliminated.

Mr. Flamant remarked that the staff representative's justification for the level of access in the present case was the same as that given in December 1983. He asked the staff representative to explain why the reasons that had justified access of 50 percent of quota in 1983 now justified a reduced amount of 45 percent of quota. The prospects for balance of payments viability in the medium term had not changed.

Mr. Goos commented that the explanations by the staff regarding the phasing of purchases were convincing and that the phasing appeared appropriate. The recently adopted guidelines stated that there would be no fewer than four purchases and that the preferred course of action would be five. Nevertheless, they did not proscribe the flexibility to go beyond five purchases in stand-by arrangements.

Mr. Jayawardena submitted that in the present case there was no apparent justification to exceed five purchases. The calendar-year argument did not warrant departure from the preferred course of action as stated in the guidelines.

Mr. Wang, Mr. Flamant, and Mr. Parmena stated that they supported Mr. Jayawardena's position.

Mr. Clark noted that the Board's decision indicated adoption of five purchases as a norm, with no indication that it should be a maximum. He accepted the explanations given by the staff for the phasing in the present case. If it were decided to approve five purchases, questions would remain about which purchase should be dropped and about how the purchases should be rephased; he was content to approve the staff's proposals.

The staff representative from the Exchange and Trade Relations Department said that although five purchases were mentioned in the guidelines, a larger number of purchases, justified according to circumstances, was not precluded. In addition, it would be to the disadvantage of the member if the proposed performance criteria for April were eliminated and the second purchase linked to the end-June performance test. The member would then not be able to make a purchase following the first purchase upon Board approval of the arrangement until August.

Another sentence in the operational guidelines approved in March indicated that the date of the last performance test would not be earlier than three months from the end of the arrangement, the staff representative continued. The fact that the program period was a calendar year was relevant in that the period of the arrangement was April 1985-April 1986 and the performance criteria would relate to that period. In accordance with the guidelines, the last test date was set for end-February 1986. One way of avoiding six purchases would have been to start with the April performance criteria and to have performance test dates every three months thereafter. With performance tests set for July, October, and January, all the requirements under the guidelines would have been met. But from an operational point of view that phasing would have been difficult to implement. The staff had considered the factors in the present case and had decided that the proposed phasing was best suited to the circumstances.

Access limits had been reduced since the Executive Board had approved the previous stand-by arrangement for Madagascar, the staff representative from the Exchange and Trade Relations Department explained. More important, as a result of the net purchase that would take place under the tranche policies, Madagascar's use of resources would increase during the proposed arrangement.

Mr. Jayawardena explained that he had not wished to suggest that performance criteria and a drawing should be scheduled for April. His only motive was to improve the phasing under the stand-by arrangement to benefit Madagascar.

Mr. Alfidja said that he agreed with those Executive Directors who had expressed concern about the proposed six purchases in the case of Madagascar, and he suggested that the Board reconsider the guidelines in order to assuage the concerns of speakers. As to the phasing of the purchases, he would advise caution in finding a solution that might, in fact, be less favorable to Madagascar than the proposal. Nevertheless, he would welcome Executive Directors' guidance in suggesting improvements to the operational measures.

Access higher than 45 percent would have been preferred by his authorities because they believed that it was more appropriate for Madagascar's balance of payments needs both in the short term and in the medium term, Mr. Alfidja continued. As had been stated previously, the signal given by the Fund was important for countries seeking assistance from the international financial community, and there was therefore a strong case for the Fund to at least maintain its exposure of 50 percent of quota for Madagascar.

His authorities were looking forward to the next review to discuss the question of import levels, along with their implications for the growth of the economy and per capita income, Mr. Alfidja concluded.

The Acting Chairman said that while he sensed some support for a modification of the phasing of performance criteria and while some questions had been raised about access, the general consensus of the Board was to support the proposed decisions.

The Executive Board then took the following decisions:

a. Stand-by Arrangement

1. The Government of Madagascar has requested a stand-by arrangement for the period of one year from April 23, 1985, in an amount equivalent to SDR 29.5 million.

2. The Fund approves the stand-by arrangement set forth in EBS/85/82, Supplement 1.

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

Decision No. 7953-(85/60), adopted
April 23, 1985

b. Exchange System

Madagascar retains restrictions on payments and transfers for current international transactions as described in EBS/84/195 and SM/84/218. The Fund welcomes the intention of the authorities to remove progressively exchange restrictions in the context of the adjustment program supported by a stand-by arrangement. In the meantime, the Fund grants approval for their retention until August 31, 1985.

Decision No. 7954-(85/60), adopted
April 23, 1985

Mr. Jayawardena commented that he was somewhat disturbed because after long Board deliberation culminating in the approval of operational guidelines on the relationship between performance criteria and phasing of purchases under Fund arrangements, a proposal before the Board was basically at variance. He recalled that that Board discussion had determined that the norm would be four purchases. Without inflicting any additional problems on Madagascar, it would be simple to modify the phasing to five purchases, thereby complying with the understandings reached at EBM/85/38. He could not agree with the present proposal. In his view, if a Board decision were being redesigned, it should be discussed further. He requested a substantive paper on the phasing of purchases wherein the staff could clarify the rules pertaining to the calendar period and final purchase that prevented the implementation of five purchases; he wished to avoid situations where there could be over-frequent reviews of performance clauses.

The Acting Chairman agreed that such a note could be useful. In any event, in instances where provision was made for more than five purchases in one-year stand-by arrangements, the staff report would include an explanation.

2. FUND BORROWING - BANK FOR INTERNATIONAL SETTLEMENTS (BIS), JAPAN, AND NATIONAL BANK OF BELGIUM - EXTENSION OF COMMITMENT PERIODS

The Executive Directors considered a paper on an extension of the commitment periods under the 1984 borrowing agreements with the Bank for International Settlements (BIS), Japan, and the National Bank of Belgium (EBS/85/95, 4/17/85).

Mr. Fujino noted that about SDR 1.7 billion under the borrowing agreements would not be drawn by the expiration of the present commitment periods due to delays in disbursing purchases or in concluding stand-by arrangements. However, it was estimated that the full amount of the agreements would be utilized by the end of the specified period in the proposed decision. In view of the circumstances, his authorities could agree to the extension of the commitment period until the end of 1985 as a parallel to action by other countries participating in the borrowing agreements. It was expected that the necessary procedure for extension would be completed by the expiration date of the present agreement.

The Executive Board then took the following decision:

The Executive Board authorizes the Managing Director

(i) to accept the proposal by the BIS that the commitment period under the 1984 borrowing agreement with the BIS be extended to December 31, 1985, and that a further stand-by commission be paid corresponding to the extended commitment period, as set out in Attachment I to EBS/85/95; and

(ii) to propose extensions of the commitment periods under the 1984 borrowing agreements with Japan (to December 31, 1985) and the National Bank of Belgium (to February 28, 1986), as set out in Attachment II to EBS/85/95.

Decision No. 7955-(85/60), adopted
April 23, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/59 (4/15/85) and EBM/85/60 (4/23/85).

3. BOTSWANA - TECHNICAL ASSISTANCE

In response to a request from Botswana for technical assistance to review the use of monetary policy instruments, the Executive Board approves the proposal set forth in EBD/85/97 (4/11/85).

Adopted April 16, 1985

4. PHILIPPINES - TECHNICAL ASSISTANCE

In response to a request from the Philippines for technical assistance in the tax field, the Executive Board approves the proposal set forth in EBD/85/99 (4/12/85).

Adopted April 18, 1985

5. ACCESS TO FUND ARCHIVES

The Executive Board approves the proposal to allow access to the Fund's archives by the Official Historian of the Bank of England, as set forth in EBD/85/96 (4/10/85).

Adopted April 17, 1985

6. APPROVAL OF MINUTES

a. The minutes of Exective Board Meeting 84/112 are approved. (EBD/85/94, 4/9/85)

Adopted April 15, 1985

b. The minutes of Executive Board Meetings 84/113 through 84/115 are approved. (EBD/85/98, 4/11/85)

Adopted April 17, 1985

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/97 (4/12/85), EBAP/85/99 (4/15/85), EBAP/85/100 (4/16/85), and EBAP/85/103 (4/19/85), and by an Advisor to Executive Director as set forth in EBAP/85/100 (4/16/85) is approved.

8. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/85/102 (4/18/85) is approved.

APPROVED: February 7, 1986

LEO VAN HOUTVEN
Secretary