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Minutes of Executive Board Meeting 85/77

10:00 a.m., May 22, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	L. K. Doe
C. H. Dallara	M. Lundsager, Temporary
	H. G. Schneider
B. de Maulde	
M. Finaish	T. Alhaimus
	M. Sugita
	D. Hammann, Temporary
J. E. Ismael	
	G. D. Hodgson, Temporary
	J. Hospedales, Temporary
	K. A. Hansen, Temporary
	A. Abdallah
	M. A. Weitz, Temporary
	E. M. Taha, Temporary
	J. E. Rodríguez, Temporary
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuâldez
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
	T. A. Clark
S. Zecchini	
Zhang Z.	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

IBRD: D. G. Greene, Eastern Africa Regional Office; D. G. Reese, Western Africa Regional Office. Administration Department: V. R. Sertic. African Department: A. D. Ouattara, Director; D. T. S. Ballali, A. Basu, M. W. Bell, E. L. Bornemann, R. O. Carstens, A. G. A. Faria, G. E. Gondwe, C. J. Hoban, J. W. Kratz, B. P. Ledoux, H. R. Lorie, R. L. Sharer, K. Thugge, A. C. Woodward. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; E. H. Brau, K. M. Huh, W. S. Tseng. Fiscal Affairs Department: H. Bierman, S. K. Chand, J. R. Modi. IMF Institute: O. B. Makalou, J. M. Davis. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder. Advisors to Executive Directors: S. M. Hassan, G. E. L. Nguyen, J.-C. Obame, T. Sirivedhin. Assistants to Executive Directors: G. Biron, Bo T., C. Flamant, A. R. Ismael, J. M. Jones, J. A. K. Munthali, K. Murakami, A. Mustafa, J. K. Orleans-Lindsay, M. Rasyid, D. J. Robinson, C. A. Salinas, L. Tornetta, B. D. White, A. Yasseri.

1. MALAWI - 1985 ARTICLE IV CONSULTATION AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1985 Article IV consultation with Malawi and review under the extended arrangement, together with proposed decisions concluding the Article XIV consultation and reviewing the extended arrangement (EBS/85/101, 4/24/85; and Cor. 1, 5/17/85). They also had before them a report on recent economic developments in Malawi (SM/85/121, 5/6/85).

The staff representative from the African Department made the following statement:

> The proposal to restore Malawi's drawing rights under the extended arrangement is predicated on the authorities' taking a number of economic policy measures, incorporated in a program designed to bring Malawi's balance of payments performance in line with that envisaged in the original arrangement. The measures, which have been taken as prior actions, include revenue measures equivalent to almost 2 percent of GDP; a 15 percent depreciation of the Malawi kwacha against its currency peg; and an upward adjustment of the interest rate structure raising deposit and lending rates by between 1 percentage point and 2.5 percentage points. The authorites also undertook to establish a timetable for the liberalization of price controls by the end of 1985, some six months ahead of the original schedule. The Government has now informed the staff that by mid-July 1985 it intends to remove 9 of the 17 items from the list of goods remaining subject to control. At that time the goods remaining under control would be maize flour, fuel, fertilizer, sugar, hoes, meat, cement, and motor vehicle spare parts. By the end of 1985 additional items will be decontrolled, leaving only 4 or 5 items, which would probably include maize, flour, and fuel. All the measures or actions required prior to Board approval have thus been implemented.
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> The staff report contained the assessment that the fiscal outcome for 1984/85 would be worse than had been assumed in the original extended arrangement. Since the issuance of the staff report, preliminary data have been received on the fiscal performance in 1984/85 and on the monetary aggregates through April 1985. These data indicate that the central government overall deficit was in excess of the program target and some MK 20 million above the estimate in EBS/85/101. However, net credit to the Central Government at the end of March 1985 was MK 1.6 million below the indicative ceiling. The reasons for the higher deficit are not clear. While I would emphasize that the preliminary fiscal outturn data are subject to revision, and consequently the preliminary deficit outturn may be reduced, at this time it appears that there was a much sharper increase in the float of uncleared checks at the end of the fiscal year than has

occurred in previous years. This supposition is supported by preliminary data on banking system credit to the Government for April 1985, which rose sharply, bringing the aggregate close to the level of the June 1985 ceiling. On this basis, the ceiling for June 1985 is likely to be very tight indeed, reflecting essentially larger than expected expenditure overruns that occurred in the previous fiscal year. The staff is in contact with the authorities to encourage them to strengthen their fiscal position by the end of June.

A further source of concern is that credit to the statutory bodies, largely accounted for by the Agricultural Development and Marketing Corporation's (ADMARC) borrowing for crop financing, did not contract as quickly as expected. At end-March 1985, this aggregate exceeded the indicative limits by MK 13.9 million, mainly because a major export contract for sales of maize to a neighboring country has not thus far materialized. The authorities believe that they will be able to find sufficient export markets for maize, and that the seasonal pattern of credit anticipated in the ceilings for 1985/86 will be restored. This is a matter, however, that the authorities will also need to monitor closely.

Since the latest preliminary data had been received on the previous day, the staff representative added, the Malawian authorities had been in touch with the staff because they felt that some undisbursed commitments had been included in the cash expenditures, thereby leading to double counting. The deficit for 1984/85 should therefore be close to the estimate in the staff report rather than substantially in excess of it. The float of uncleared checks at the end of the fiscal year, as reflected in the figures for April, had nevertheless been larger than usual, although banking system credit to the Government should be more in line with the June 1985 ceiling than the staff had anticipated when it had decided to inform the Executive Board of the preliminary expenditure data.

The reference in the footnote on page 20 of the staff report to tea prices for February and March should be to 1985 and not to 1984, the staff representative explained. Tea prices were even weaker than expected when EBS/85/101 had been written and the staff was also not ready to make any changes in its estimates of the volume of exports.

Mr. Abdallah made the following statement:

The performance of the economy of Malawi during the first two years of the extended arrangement has been generally satisfactory. Output growth resumed in 1982 and became stronger in the next two years, with real GDP growing by 3.5 percent in 1983 and by 4.1 percent in 1984. This expansion was led by the agricultural sector, particularly the increase in output of smallholders reflecting, in part, favorable weather conditions and a positive response to higher producer prices. The balance of payments has also improved in recent years, benefiting from a rise in exports and a deceleration in import demand. There has been a steady reduction in the current account deficit, which peaked in 1979 at a level equivalent to about 25 percent of GDP. The only setback occurred in 1983 due to a 20 percent decline in Malawi's terms of trade and disruptions along the traditional trade routes that were beyond the control of the authorities. With strong export performance in 1984, the current account deficit narrowed to 3.9 percent of GDP, a drop of some 8.5 percentage points compared with the previous year. It is important to note with regard to Malawi's external payments situation that the economy has to bear a heavy burden in the form of insurance and freight charges because the country is not only landlocked but has to incur added transport costs owing to difficulties on more direct routes.

Despite the favorable outturn in the real and external sectors, other areas have remained worrisome. First, inflationary pressures have not abated mainly on account of the high c.i.f. value of imports, the impact of price liberalization--an action which has been taken with a view to improving the allocation of domestic resources--and the effect of the two devaluations that have been implemented since the inception of the program. Second, the implementation of the fiscal program, though generally successful, has not been without problems. Although the ceiling on net domestic credit to the Government has been satisfied thus far, some of the fiscal targets established under the program have not been attained. In fact, fear of expenditure overruns during the midterm review of the program last November caused a delay in the completion of the review. Notwithstanding these difficulties, it is noteworthy that significant fiscal adjustment has been made during the program period. The overall deficit has been halved from a peak of about 12 percent of GDP in 1981/82, and accordingly recourse to domestic bank financing of the deficit has been held to the minimum allowed under the program. The ceiling on net domestic assets for December 1984 was breached on account of the need for increased crop financing by the Agricultural Development and Marketing Corporation, in view of the better than expected performance of the agricultural sector.

Directors will recall that the original objectives of the extended arrangement were to raise the rate of economic growth to about 3.5 percent, reduce imbalances in the external sector, and reduce the government budgetary deficit to 4.8 percent of GDP by 1985/86 while endeavoring to bring the rate of inflation to between 7 percent and 8 percent. While the economy has come closer toward these objectives, the authorities are aware that a number of structural problems continue to constrain the economy from operating at full capacity. For example, transportation bottlenecks which affect Malawi's foreign trade are expected to persist in the medium term, and the debt burden will remain heavy up to 1988. Even with the decline projected after that year, the debt burden will still be high by historical standards. These concerns have prompted the Malawian authorities to continue to formulate policies within a medium-term framework, as has been done in designing the third year of the program. In this regard, they are currently discussing with the World Bank the question of a third structural adjustment loan (SAL) aimed at complementing demand management policies with those geared toward increased output and economic diversification.

As mentioned above, performance in the agricultural sector has been satisfactory. Production, particularly with regard to maize, has responded favorably to price incentives helped by good weather conditions. Consequently, Malawi has been able to attain self-sufficiency in food production, and has even managed to export large quantities of grain to neighboring countries in 1984. The authorities are studying the structure of prices for various crops because the internal terms of trade may have shifted more in favor of maize production; they intend to remove any discrepancies before the next crop season. This is one of the issues being discussed with the World Bank mission that is presently in Malawi to appraise the SAL.

Fiscal performance has been mixed over the program period. In the revenue area, on the one hand, discretionary tax measures have strengthened revenue performance, and the 1985/86 budget which was presented to Parliament last March contained a variety of measures that are expected to yield total additional revenue amounting to MK 40 million, equivalent to about 2 percent of GDP. The measures announced include a 10 percent export levy on tea and tobacco and a 5 percent tax on sales of agricultural products in the case of those producers who pay minimum income tax. In addition, the amount of rent paid on government-owned land has been raised while steps have been taken to make the payment of corporate income tax more current. On the other hand, the increase in revenue has been constrained by the narrow tax base. The authorities see this as a problem which should command high priority, because tax rates are already very high and therefore limit the scope for additional action. Efforts aimed at controlling expenditure also experienced some difficulty. Thus steps are being taken to strengthen the monitoring system by requiring government agencies to file monthly expenditure reports with the Ministry of Finance. The authorities have agreed, meanwhile, to report to the Fund also on a monthly basis cumulative data on expenditure during the remainder of the program. The decision to implement such a tight schedule reflects the awareness on the part of the Government that expenditure control is a crucial element of the adjustment process in Malawi. Bearing in mind the need to adequately maintain the existing capital stock, the authorities have attempted, in consultation with the World Bank staff, to include a more realistic allocation in the 1985/86 budget for this purpose than hitherto had been the case. Such realistic budgeting is expected to further minimize the risk of expenditure overruns.

As regards the parastatals, a number of tariff increases have been approved by the Government, including a 50 percent increase in domestic fares for Air Malawi, effective January 1985, a 15 percent increase in tariffs for Malawi Railways, and a 10 percent increase in electricity charges for households, and 15 percent for industrial users. The tariff rates for water in Blantyre and Lilongwe have also been raised. These measures should help to minimize the financial losses of these corporations and reduce their need for budgetary support. In the particular case of Malawi Railways, the losses have been aggravated by the nonoperation of the two routes to the seaports in Mozambique because of insurgent activities in that country.

The conduct of monetary policy has mainly reflected demand restraint measures. Following the rise in credit to ADMARC at the end of 1984, which caused a breach of the ceiling on net domestic assets, the authorities have decided to limit the use of seasonal credit by state corporations. Interest rates remain positive in real terms with further adjustments of deposit rates by between 1 percentage point and 2 percentage points becoming effective April 15, 1985. These and other actions are aimed at mobilizing domestic financial resources as well as reducing excess demand for credit.

Following the action implemented on April 2, 1985 involving a 15 percent devaluation of the Malawi kwacha, the Malawian authorities have reaffirmed their commitment to continue managing the exchange rate in a flexible manner. This should help maintain competitiveness and contribute toward balance of payments adjustment over the medium term.

The authorities realize that the debt service ratio will remain high over the medium term. They have therefore taken a cautious attitude toward external borrowing on commercial terms. Following the removal of the hump through debt rescheduling, the authorities now consider that the need for further rescheduling has become less pressing. Barring unforeseen developments, the targeted external reserve position should enable the authorities to fully service their external obligations.

Finally, Directors will have noticed that the proposed decision calls for a reduction in the amount of resources from the level agreed upon when the extended arrangement was approved in September 1983. In the staff's view this was necessary considering the interruption in the sequence of purchases. In this connection, it is necessary to stress that the delay in completing the review should not be taken as a lack of commitment to the program. The authorities are continuing to take corrective action, and the 1985/86 program, in particular, incorporates a number of policy measures aimed at keeping the adjustment process on course as well as correcting slippages which have occurred in the past. I will therefore ask Directors to approve the proposed decisions.

Referring to the supplementary statement made by the staff representative, Mr. Abdallah observed that the Malawian authorities had not only detected some element of double counting in the preliminary data on the overall deficit but had discovered an apparent mistake in the computer printout on the revenue side. Also, at the beginning of the financial year ministries tended to spend at a more rapid rate as they tried to restock exhausted supplies.

The Malawian authorities had indicated that the fiscal position should be strengthened by the flow of receipts to the Government, particularly in light of the new fiscal measures and the commencement of the tobacco auctions, Mr. Abdallah added.

It was becoming even more apparent to the Malawian authorities that the provision of preliminary raw data could lead to erroneous judgments, Mr. Abdallah noted. The authorities had therefore indicated their wish for more time to make up discrepancies in the data to enable them to avoid misunderstandings.

Mr. Clark remarked that the inability to agree on policies in 1984 that would have allowed the program for the second year of the extended arrangement to proceed had been disappointing. Fortunately, the policy actions taken, together with favorable developments on the external account, had limited the damage from the pause in the adjustment effort. Indeed, in some respects, Malawi's economy had performed well in 1984. The new and determined measures that had allowed the extended arrangement to be reinstated for the third year held out the encouraging prospect that Malawi's external position would be returned to viability within the next few years, as planned.

However, major problems remained, especially relating to the control of public expenditure, the operations and financing of the parastatals, and because of the concentration of export receipts on a relatively small number of commodities subject to volatile demand and international prices, Mr. Clark continued. In addition, Malawi's trade continued to be plagued by transport difficulties that were largely beyond the Government's control. Moreover, overall equilibrium in the balance of payments would remain heavily dependent on aid inflows and other official financing, and further efforts would be needed to encourage inflows of private capital. Nevertheless, Malawi seemed to have the opportunity to set its economy back on a sustainable path.

Fiscal policy would be the key to successful adjustment during the third year of the program, Mr. Clark considered. There was a clear need for more effective expenditure control and he had been encouraged in that respect by the measures discussed on page 8 of EBS/85/101. In the 1984/85 fiscal year, the deficit had apparently been kept at 6 percent of GNP--which itself seemed much too high a figure--by further reductions in the development budget and by a number of unforeseen and nonrecurring boosts to revenue. Any further cut in the development budget as a means of offsetting an overrun on current expenditure would make it doubly difficult to achieve the authorities' growth targets. It was especially important that adequate domestic finance be available as a counterpart to structural adjustment loan disbursements without being pre-empted by other items of expenditure.

The improvements in expenditure monitoring needed to be accompanied by adequate arrangements for the control of expenditure, Mr. Clark emphasized. His concern had been reinforced by the latest developments reported by the staff representative. He had taken note of the package of revenue measures. He asked how the new export levy on tea and tobacco, introduced in connection with the recent depreciation of the exchange rate, was likely to affect production incentives and competitiveness in those sectors. More generally, he agreed with the authorities on the need to widen the tax base, and he encouraged them to examine the issue, perhaps with Fund or World Bank technical assistance.

The unexpectedly good performance on the external account in 1984 had had a significant effect on domestic liquidity, Mr. Clark remarked. He inquired about the availability of instruments for sterilizing such inflows of foreign exchange. The policy objective for 1985/86 of restoring monetary growth to more normal levels and the emphasis given to accommodating private sector demand for credit were appropriate. However, those goals were only likely to be met if the Government was able to secure adequate fiscal control.

Malawi's strong trade performance in 1984 had been partly attributable to external factors, especially to large price increases for some major export commodities, Mr. Clark stated. But it also reflected the benefit of pricing policies that had provided adequate production incentives to export sectors. The authorities should maintain an exchange rate that ensured the continuation of those production incentives. For that reason, having in mind the present rate of inflation in Malawi, he welcomed the recent further devaluation of the kwacha.

Over the longer term, efforts to diversify exports must have priority, Mr. Clark considered. Much of the recent improvement in the trade performance had been based on tea, tobacco, and maize exports, probably due in each case to special and temporary factors. He had noted the staff projection of a rise in import volume averaging only 2 percent a year over the few years ahead, and wondered how consistent that was with the authorities' medium-term growth and balance of payments objectives.

The present debt service ratio and its slow projected decline in future made it vital for the authorities to observe the limits on non-concessional borrowing, Mr. Clark said. He welcomed the authorities' intention to avoid a further debt rescheduling in 1985, although the concentration of repayments in 1986 suggested the possibility of a need for rescheduling in that year. The medium-term scenarios, which he noted had been truncated at 1988 rather than, as in 1984, extended to 1990, clearly revealed the continuing burden of debt and illustrated the need for a substantial improvement in capital flows if economic growth was not to be held back. The authorities should examine measures that might increase inflows not just from multilateral institutions but from private sources as well.

Referring to certain more structural issues, Mr. Clark observed first, that Malawi had already taken some important steps in the area of prices, and that further moves were planned before the end of the extended arrangement. Also, he asked the staff to explain the relationship between the Government's decision to double its contribution to the fertilizer fund and its undertaking to eliminate the fertilizer subsidy. He noted Malawi's continuing difficulties with transport for exports and imports, which was imposing a considerable extra burden on the economy. Was there any likelihood of an improvement in that situation? Finally, he welcomed the close collaboration between the Fund and the World Bank, which clearly had a vital role in sustaining Malawi's adjustment effort, most immediately in the context of the third structural adjustment loan. Although the World Bank would be reviewing Malawi's investment program, he wondered whether that review might not be extended to cover a plan designed either to return parastatals to profitability, transfer their assets to the private sector, or to close them down.

Mr. Hammann said that he had been pleased to note that in spite of the slippages in fiscal and monetary policy, the program appeared to have been brought back on track and that the authorities were showing a strengthened commitment to the program for the third and final year under the extended arrangement. He had also been reassured by the staff representative's clarification of his opening statement. The authorities had in fact implemented a noteworthy series of policy measures. The devaluation of the kwacha, the improved monitoring of government expenditures combined with the planned revenue package, efforts to rectify the financial position of public enterprises, and a more appropriate monetary and interest rate policy were steps in the right direction that should enhance the prospects for a successful completion of the program under the extended arrangement.

Producer prices would be set in close consultation with the World Bank and a third structural adjustment loan was expected to be approved at the end of 1985, Mr. Hammann noted. The Fund and the World Bank had cooperated with success in Malawi to deal with serious internal and external imbalances through appropriate adjustment policies. However, even if all the policies under the current program were implemented, in light of the risks mentioned by Mr. Clark, Malawi should continue to pursue prudent development policies combined with fiscal and monetary restraint so as to secure a viable balance of payments position.

Improved, stronger monitoring of government expenditures would be crucial to a successful implementation of the program, Mr. Hammann observed. The overall fiscal performance, and in particular the overruns in current expenditures, were a cause for concern, all the more so since those developments had been accompanied by a drastic reduction in capital expenditures. Moreover, the fiscal stance envisaged for the years ahead was not without risk. Fiscal adjustment in 1985/86 was based on the assumption that a strong rise in expenditures would be more than compensated for by a rise in revenues. However, allowance had to be made for the already high level of revenues and exports in the current year. Therefore, he hoped that the revenue estimates were not too optimistic.

The monetary and credit expansion provided for in the final two years of the program had apparently already largely taken place, Mr. Hammann commented. Thus, despite the staff statement at the beginning of the meeting, a drastic slowdown in monetary growth would be required if the June 1985 credit ceiling was to be observed. He had been glad to note that the authorities were determined to make interest rates positive in real terms, which might help to contain a renewed excessive growth of monetary aggregates. However, he would welcome any additional comments by the staff on the prospects of Malawi observing the credit ceilings for the year to come.

In supporting the proposed decision, Mr. Hammann stated that the arguments of the staff leading to the proposed curtailment of access for the remainder of the arrangement could be applied more generally.

Mr. Vasudevan noted that the delay in concluding the review, on account of expenditure overruns and the consequent interruptions in scheduled purchases, had led the staff to propose a reduction in the total amount of the arrangement from SDR 100 million to SDR 81 million and to phase the remaining drawings totaling SDR 47 million over six installments. Meanwhile, the program for the third year of the arrangement was being prepared, enabling the restoration of purchasing rights.

The position taken by the staff had to be seen in the light of Malawi's economic performance in the past year, Mr. Vasudevan considered. Output growth and gross domestic savings, at 4.1 percent and 14.3 percent of GDP respectively, had been higher than originally expected. The liberalization of price controls had continued; producer prices for principal crops had been raised. But consumer price increases had been limited to about 13 percent in 1984, as programmed, despite price liberalization, two devaluations since the inception of the program, large liquidity expansion, and the high value of imports. The overall balance of payments, after making allowance for debt relief, had been in surplus by SDR 63 million in 1984, compared with an estimated deficit of SDR 10 million and an actual deficit of SDR 43 million in 1983. Those positive results had not been foreseen at the beginning of the second year of the arrangement.

Liquidity expansion had been affected in 1984 by a large increase in quasi-deposits reflecting windfall earnings of the tea exporting sector, a development outside the influence of the authorities, Mr. Vasudevan continued. There had clearly been two phases in the development of bank credit: up to September 1984, credit had grown more slowly than projected, and had then expanded substantially in subsequent months. The staff had attributed that acceleration to two exogenous elements, namely, considerably higher than expected purchases of domestic crops by statutory bodies and slower shipments of export crops, and the slack in domestic sales. The latter component had been left unexplained in the staff report, and he asked what reasonable explanation there was for the sluggishness of domestic sales after September 1984.

Judging by the tone of the staff report, the fiscal record was unsatisfactory, Mr. Vasudevan said. Yet the overall central government deficit as a percentage of GDP would exceed the program target of 7.7 percent for 1984/85 by a mere one half percentage point. The discrepancy between the estimated outturn, which might well materialize, despite the staff representative's additional statement, and the program target in 1984/85 was thus much less than the 1.4 percentage point discrepancy in 1983/84. The point was worth emphasizing because it revealed the substantial fiscal effort made by the authorities. True, there had been expenditure overruns in 1984/85 but they were only 3.7 percent above the program target, well below the overrun of 4.9 percent recorded in 1983/84. It was also worth noting that the overall financial position of the parastatals had improved greatly in 1984.

The interruptions in the schedule of purchases should not be interpreted unfairly as evidence of an inadequate adjustment effort or of insufficient commitment to adjustment by the authorities, Mr. Vasudevan considered. The World Bank's assessment of Malawi's situation in Appendix III was crisp and realistic in stating that "the Government has demonstrated a firm commitment to addressing the structural problems the country faces and to dealing with them in an expeditious manner." Malawi's commitment could be seen also from the number of steps taken and envisaged in the monetary, fiscal, and exchange rate fields under the 1985/86 program. The new measures had been amply described in the staff report, in Mr. Abdallah's statement, as well as in the statement by the staff representative.

From the information that could be gleaned from the staff report, the staff decision to effect a reduction in the amount of the arrangement had been based on unconvincing grounds, Mr. Vasudevan stated. He was not arguing that performance criteria and expenditure limits were unimportant, nor that the staff's original projections were entirely wrong, but rather that those projections might not be valid under all circumstances. Clearly, output, trade, and other variables had moved so far out of line from the original projections that monetary and fiscal developments had been affected differently than stipulated in the program. It would be helpful to have an explanation of the rationale and criteria underlying the staff's decision and to know whether other courses of action had been considered. It would also be useful to know why the second scheduled purchase could not have been made once understandings on the program for the third year had been reached, perhaps with a waiver for the overshooting of the credit ceilings. According to the statement by the staff representative, the restoration of drawing rights was predicated on the authorities taking a number of policy measures under the program, presumably during the third year. He had thought that the purchase associated with the end-March criteria had been predicated on understandings being reached for the last year of the program, the basic objectives of which had been achieved.

He recognized the need for developing economies to undertake large adjustment efforts over the medium term if they were to address their structural problems effectively, Mr. Vasudevan said. Malawi's medium-term prospects, as currently assessed and presented in the form of balance of payments projections up to 1988 in Table 8 of EBS/85/101, were crucially dependent on the assumption of a 3 percent average annual increase in the value of exports. He wondered how realistic that assumption was and how much technical work had gone into it. Even under the current assessment, total debt service as a percentage of exports of goods and nonfactor services would, after debt relief, decline from 35.2 percent in 1984 to 32.7 percent in 1988.

He was uneasy about the many stringent elements of the 1985/86 program, Mr. Vasudevan added. The idea of monthly ceilings on expenditures, although appealing, assumed that fiscal expenditures were directly controllable, a proposition much contested in the literature. Moreover, the idea was not practical even in many developed countries. Had the staff made allowance for slippages in working out the monthly limits on expenditures? If so, he would be curious to know what methodology or technique the staff had applied in fixing the monthly ceilings. Development expenditures had been postulated to rise by 35 percent in 1985/86 over the estimated outturn of MK 134 million for 1984/85, in contrast to the decline of 6 percent in 1983/84. He wondered how close a relationship there was between development expenditures and current expenditures, and whether such large development expenditures could be absorbed.

The staff's method of determining broad money growth in 1985/86, which was estimated at only 8.9 percent, was rather curious, Mr. Vasudevan remarked. As explained on page 28 of the staff report, broad money growth was the difference between the growth in nominal GDP in 1984/85 and 1985/86, and the estimated growth of broad money in 1984/85. It was also not clear to him how the projected expansion of broad money in 1985/86 fitted in with the basic assumptions implied in the program of a 15 percent rise in consumer prices and a rate of growth in real GDP at constant factor costs of 2.7 percent.

The World Bank's assistance to Malawi had been useful, Mr. Vasudevan observed. However, he was not sure that it was appropriate for the Fund staff to express the view that the World Bank should take up a number of issues "such as cross-subsidization among ADMARC's trading accounts and the investment strategy of the major public enterprises...as central issues in the consideration of a third SAL." He considered such advice by the Fund to be an instance of cross-conditionality, or likely to lead to it. The World Bank staff had given its own views on the structural adjustment loan in Appendix III; what kind of advice might it have given to the Fund staff, if it had wished to do so?

Malawi's significant adjustment efforts needed to be continued and supported with full understanding, at the present critical stage in its development, and therefore he supported the proposed decisions, Mr. Vasudevan concluded.

Mr. Dallara observed that Malawi's performance under its extended arrangement had been somewhat mixed. The considerable delay in setting program parameters for 1985 and thus in completing the review were of some concern, particularly in light of the generally good performance of exports and the external accounts. Economic growth was quite strong and should make it easier for the Malawian authorities to take adjustment measures.

Several actions taken in 1984 had had significant positive effects, Mr. Dallara acknowledged. The producer price increases for many crops had led to substantially increased output and exports, and the commitment to raise prices further before the start of the new crop year was welcome. Particularly noteworthy in that connection was the emphasis on export diversification, which was to be effected by means of selective increases in prices of farm products. Furthermore the additional steps taken to reduce the number of goods subject to price control should be followed up by wider decontrol in 1985.

The fiscal effort had perhaps been the area of weakest performance, with the central government deficit, including grants, reaching 6 percent of GDP compared with the 5.4 percent programmed, Mr. Dallara commented. The slippages had occurred primarily on the expenditure side, with "other current expenditures" apparently being much higher than expected. Also, a public sector wage increase had been advanced by several months, leading to a wage bill about half again as large as targeted. For the current fiscal year, the deficit was targeted to fall to 4.1 percent of GDP, but unfortunately all the adjustment was placed on revenues: expenditures were programmed to increase by 20 percent, probably resulting in a significant real increase in spending. He understood the need to maintain existing infrastructure and undertake new investment, but the corollary was a downward adjustment in other categories of current spending. Since the wage increase had already been granted, the adjustment of the wage bill by means of a reduction in employment should be accelerated. While no specific commitments appeared to have been made regarding reductions in government employment during the course of the current fiscal year, he nonetheless urged the authorities to consider that possibility.

The imposition of an export levy on tea, tobacco, and some agricultural products was a matter of concern, Mr. Dallara remarked. Experience in other countries suggested that once such levies were imposed, they became critical sources of fiscal revenue and thus became increasingly difficult to eliminate. In the meantime, the profit margins of exporters who were price takers on world markets might be eroded, thereby reducing their incentive to produce goods for export. Also, as Mr. Abdallah had pointed out, income tax rates were already high, although some slight reduction was programmed for 1985. For those reasons, he urged much stronger expenditure control and less reliance on revenue-raising measures for fiscal adjustment.

Efforts to improve the financial stance of the public enterprises were critical to the adjustment effort, Mr. Dallara noted. Tariff increases had already been implemented, but the liquidation of those enterprises whose function was not vital to the public sector would be especially welcome. The return of more economic activity to the private sector--the marketing of agricultural products came immediately to mind--could have a significant effect on improving the medium-term viability of the economy.

Recent adjustments in monetary policy appeared to have contained the excess growth in money supply in 1984, Mr. Dallara went on. Some interest rates had become positive in real terms, an essential prerequisite for maintaining a high rate of domestic savings. In addition, while other measures such as tariff increases should improve the situation of the parastatals, it was reassuring to note the separate performance criterion limiting credit to those agencies.

The Government recognized that debt rescheduling entailed a higher debt servicing burden, which limited its advantage as a way to attain medium-term balance of payments viability, Mr. Dallara observed. It was unfortunate that the kwacha had appreciated in real effective terms in 1984. The authorities were committed to avoiding a weakening of Malawi's competitive position and had devalued the currency again in April. However, he would be interested in learning from the staff whether the competitive position would have to be strengthened further, especially in light of Malawi's interest in export diversification. The exchange arrangements under the final year of the extended arrangement had been discussed in only vague terms in the staff report.

The World Bank's role in promoting structural adjustment was gratifying, although Malawi's experience confirmed that an extended arrangement was not necessarily the best approach for the Fund to take even where structural adjustment was needed; a one-year or 18-month stand-by arrangement would be more appropriate, Mr. Dallara considered. Thus, the staff had acted properly in scaling back and rephasing purchases under the arrangement, especially in view of Malawi's prolonged use of Fund resources: some seven programs had been supported during the past ten years, and outstanding drawings were high. The package of policy measures implemented by Malawi during the past few months in the exchange rate, monetary, and fiscal areas provided assurances that the authorities were committed to a continuation of the adjustment effort, and the medium-term outlook indicated that a viable balance of payments position was within grasp. Thus, he could support the proposed decisions.

Mr. Wijnholds stated that he was in general agreement with the staff appraisal and that he could support the proposed decisions. The resumption of the interrupted extended arrangement with Malawi, albeit with a revised program, was the preferred course of action from the member's point of view as well as from that of the Fund. The reduction of the amount of the remaining purchases to avoid an unduly large concentration of access in the final year was a logical step and conformed to earlier practice.

The performance of Malawi's economy in 1984 clearly showed how important it was to differentiate between what could superficially be viewed as a rather favorable outcome and what would be a sustainable performance in a medium-term context, Mr. Wijnholds commented. On the one hand, there was the better than projected real GDP growth of 4.1 percent, to which agriculture and exports had contributed most; the rise in domestic savings to over 14 percent of GDP, a substantially higher ratio than had been recorded in earlier years; the significant improvement in the balance of payments, with the current account deficit down to less than one third of that recorded in 1983; and the increase in gross official reserves, which at the end of 1984 had stood at 2 1/2 months' imports as against a mere 2 weeks' imports a year previously. On the other hand, the increase in the money supply had been excessive and the central government deficit was again higher than programmed. The good performance in a number of areas, to which favorable external conditions seemed to have contributed importantly, had therefore not been matched by sufficiently sound domestic financial policies. A particularly worrisome development was the continued lack of effective control over government expenditure.

It was heartening to note that the authorities agreed on the need for a cautious approach in coming years, as was borne out by the adoption of the program for 1985/86, Mr. Wijnholds said. Given the uncertain outlook for commodity prices, the transportation difficulties encountered by Malawi, and the heavy debt service burden that it faced in the coming years, the country had no viable alternative but to continue on the path of sustained adjustment. He had been pleased to learn that all measures envisaged under the new program had already been taken. The program itself was consistent and balanced, and in the staff's judgment, if it was successfully implemented, a viable balance of payments position would be achieved by 1986. He had been a little worried by the staff representative's statement until he had learned that the figures on government expenditure were subject to an element of double counting and that the June ceilings were not likely to be exceeded; he hoped that that would prove to be the case.

Finally, Mr. Wijnholds noted that consumer prices were expected to rise in 1985 by 15 percent. He asked whether those inflationary pressures were due to the effects of devaluation and price liberalization, factors to which Mr. Abdallah had drawn attention. Furthermore, how would the rather steep reduction in inflation projected for 1986 and 1987 be brought about?

Mr. Doe stated that, in comparison with 1983, the economic performance of Malawi had improved significantly in 1984. Real GDP had expanded more rapidly, reflecting a growth of agricultural output. The overall financial position of the public enterprise sector had improved to the point of showing a surplus. In the external sector, rapid growth of exports together with a reduction in imports had contributed to the narrowing of the current account deficit to 4 percent of GDP and ultimately to a reversal of the overall balance of payments position from a deficit to a surplus. Accordingly, the gross official reserves of Malawi had increased substantially in 1984. Yet the overall fiscal deficit on central government operations in 1984/85 seemed larger than indicated earlier. Likewise, the Government and some of the statutory agencies had made large use of bank credit. The need for restraint in those areas could not be overstressed.

As for the prospects and policies envisaged in the 1985/86 program in the fiscal and external sectors, Mr. Doe noted that the additional revenue measures taken at the beginning of 1985 would certainly contribute toward the projected reduction of the fiscal deficit to about 4 percent of GDP. The overall outcome would depend greatly on the Malawian authorities' ability to rein in the growth of government spending. In that context, the spending overruns in recent years and the statement by the staff representative about the possibility of a large float or excess expenditure at the end of FY 1984/85 were not encouraging. Therefore, he strongly urged the Malawian authorities to monitor closely expenditure and respond swiftly with appropriate measures to any slippage that might occur in 1985/86.

The commitment of the Malawian authorities to continue to review the prices of goods and services produced by public enterprises so as to adjust them eventually to reflect costs and lessen reliance on government subsidies and transfers was welcome, Mr. Doe went on. The 50 percent increase in the domestic air fares of Air Malawi and the increase in water and electricity tariffs at the beginning of 1985 were noteworthy in that respect. However, some public enterprises were still projected to record rather large deficits, and additional measures needed to be taken to avoid increasing the burden on the government budget.

Although the authorities had depreciated the kwacha by 15 percent in April in order to maintain the competitiveness of Malawian exports, a much slower rate of growth of exports was projected for 1985 relative to 1984, Mr. Doe noted, thereby contributing significantly to the weakening of the current account deficit. He wondered whether the projections of export earnings for 1985 were not somewhat conservative, based on 1984 export performance. External debt might remain relatively high in the medium term. Consequently, the authorities should be prudent and adopt policies conducive to an improvement of the debt profile of the country.

Finally, Mr. Doe observed, access under the arrangement had been reduced by the equivalent of about 50 percent of quota, because "of the interruption in the sequence of purchases." He asked the staff for a fuller explanation of the basis for that recommendation and its implications for the economic and financial prospects of Malawi. He endorsed the proposed decisions.

Mr. Rye observed that in a number of key respects Malawi provided an object lesson of what could be achieved in the face of many severe difficulties by a small, impoverished, landlocked economy to restructure and enhance the performance of its economy, notwithstanding some problem areas. The authorities had developed and implemented a consistent program adequate to sustain the restoration of the extended arrangement, on which he would make two general points. First, the excessive growth in broad money of about 30 percent in 1984/85 had been partly if not mainly the result of a large and welcome improvement in the external accounts. When monetary policy was not well equipped to deal with such developments, as in the absence of a developed capital market, a country like Malawi was reduced to admitting, as stated in paragraph 8 of the letter of intent, that "given the substantial increase in the net savings of the private sector as a result of the increase in export earnings, and the reduction in imports, it is likely that private sector demand will rebound strongly in 1985. Therefore, the attainment of the [medium-term] current account objectives will require a significant improvement in the financial position of the public sector...." Thus, the need to offset the monetary expansion coming from the external sector by a scaling back of the income and monetary injections to the private sector through the government deficit underlined the importance of the authorities' resisting any temptation, for whatever reason, to ease up on fiscal policies. It was also important, as Mr. Clark had pointed out, that the administrative apparatus be in place and working efficiently to ensure that the authorities' good intentions of restraining expenditure were translated into reality. He joined Mr. Dallara in urging that fiscal restraint be concentrated on the expenditure side, which seemed unfortunately to be shrouded in uncertainty.

Second, the staff had arrived at revised access for Malawi of SDR 81 million, Mr. Rye said. In that regard, he recalled that his chair had drawn attention on a number of occasions to the paucity of information on the calculations underlying the magnitude of access, or in other words, on the translation into practice of the principles laid down by the Executive Board. While he naturally accepted that a good deal of judgment must enter into the assessment of access, it was possible in Malawi's case to focus on the precise adjustment--from the original SDR 100 million to SDR 81 million--arising from the suspension of the program. The staff paper gave no clue to how that new figure had been arrived at. The two most obvious methods did not appear to have been applied: SDR 81 million was not the balance left after deducting from SDR 100 million the two purchases not made in 1984-85, totaling SDR 22 million; nor did it reflect a prorating of an apparent six-month hiatus in the program, which would result in an amount more like SDR 83 million.

In conclusion, Mr. Rye stated, Malawi deserved the support of the Fund and of the international community more generally, and he supported the proposed decisions.

Mr. Taha said that he was in general agreement with the staff appraisal and that he could support the proposed decisions. The performance of the Malawian economy in the second year of the extended arrangement had been mixed. The balance of payments had strengthened, reserves had risen, output had expanded, and inflation had stabilized. However, the authorities had failed to implement firm financial policies. Expansionary fiscal and monetary policies had defeated the objectives of the program in those areas.

The new program for 1985/86 appropriately focused on strengthening financial policies, Mr. Taha noted. Virtually all the necessary measures had already been implemented. On the fiscal side, a number of revenue-boosting and expenditure control measures were in place. As the authorities had recognized, there was no room for further slippages, especially on the expenditure side, and steps had been taken to improve the system of monitoring and controlling expenditures.

He supported the authorities' intention to pursue a tight credit policy so that liquidity expansion was limited to what was consistent with financial stability, Mr. Taha commented. He was glad that incentives to save, and to keep private capital inside the country, were being increased.

Improving the financial position of statutory bodies should also help put the public finances on a sounder financial footing, Mr. Taha continued. The measures taken so far were commendable, particularly the upward adjustments in tariffs. He had also been pleased to note that the adequacy of those tariffs would be re-examined during the midyear review of the program.

With respect to policies on production and prices, Mr. Taha noted that the authorities, working closely with the World Bank, were aware of the need to continue to adjust domestic prices in order to further improve the allocation of resources and to provide adequate production incentives for domestic production and exports.

Malawi's external policies, which were based on a flexible exchange rate strategy, the expansion and diversification of exports, and a cautious external borrowing policy seemed appropriate, Mr. Taha remarked, and their policies, together with firm demand management, should improve Malawi's economic prospects over the medium term.

Mr. Hodgson said that he had found the staff's analysis to be fair and accurate and that he supported the proposed decisions, including the reduction in the amount of Fund resources to be made available under the program and the rephasing of purchases.

Malawi had experienced a year of mixed results in 1984, Mr. Hodgson observed. On the positive side of the ledger, the strong growth in output based on continued recovery of the agricultural sector, the sharp increase in domestic savings, and the considerable strengthening of the balance of payments current account were all noteworthy developments. External conditions, particularly the terms of trade, had made a considerable contribution to the recovery of the external accounts. The Malawian authorities had also taken major steps to realign and decontrol domestic prices, thereby helping to restore incentives to production in the agricultural sector, which seemed poised for further strong growth in 1985.

On the negative side of the ledger, the authorities unfortunately had not exercised adequate control over monetary and fiscal policy, Mr. Hodgson commented, nor had they maintained a sufficiently flexible approach toward exchange rate management. The rapid growth in broad money in 1984/85 was partly related to inadequate sterilization of higher than expected foreign exchange earnings and partly due to the fiscal slippage. The increase in revenue during 1984/85 had actually surpassed the program target but had been swallowed up by overshooting in a number of categories of current expenditure. Development expenditures appeared to have borne a disproportionate share of the fiscal adjustment, the need for which had become all the more necessary because external loans had fallen short of expectations.

The mixed results over the past year had raised legitimate concerns about the attainability of the goals of the extended arrangement, and might indeed have raised some doubts about the appropriateness of an extended arrangement for Malawi, Mr. Hodgson said. The staff had had little choice but to delay the review of the program and to postpone purchases until the intentions of the Malawian authorities had become clear. That being said, it was reassuring to learn that the authorities had committed themselves to the adjustment program with renewed vigor and had already implemented a wide range of measures that should put the program back on track. A reduction in the amount available under the extended arrangement and a rephasing of purchases seemed to be fair and correct responses in view of the degree of adjustment involved.

He welcomed the recent 15 percent devaluation of the kwacha against its currency composite and the authorities' commitment to manage the rate flexibly, Mr. Hodgson went on. The favorable balance of payments results in 1984/85 had been due in part to external factors that might not recur, making exchange rate management all the more important. He asked the staff whether it considered that a pegged rate, which was periodically adjusted, was still appropriate for Malawi. If the exchange rate was to be an effective policy tool, domestic producer prices must also be allowed to adjust to ensure that adequate incentives remained in place. The authorities' intention to restore export incentives through an appropriate pricing policy was welcome, as was their intention to consult the World Bank on pricing policy generally. He was gratified as well by the authorities' intention not to seek rescheduling in 1985; the debt service ratio--33 percent in 1985--was heavy but not insurmountable. Nevertheless, if the debt burden was to be managed over the medium term, it was imperative for Malawi to maintain its export competitiveness.

The 1985/86 adjustment program also required more effective demand management, Mr. Hodgson considered. The reduced fiscal deficit, greater reliance on net foreign financing of the deficit, and the shift of expenditure in favor of development outlays all seemed appropriate. He was somewhat concerned that more had not been done to limit current expenditures. However, he noted that fiscal monitoring procedures had been strengthened, which should prevent a repetition of the slippages in 1984/85. In addition to more systematic price adjustments, a greater effort was apparently required to improve the efficiency of the parastatals. He wondered whether the World Bank might not have a more explicit role to play in that connection.

Measures to make the interest rate structure positive in real terms and to reduce liquidity in the economy were both appropriate and welcome, as was the intention to ensure adequate liquidity to the private sector under the program, Mr. Hodgson remarked. Fortunately, ceilings had also been placed on credit to the parastatals, thereby reinforcing the need for improved managerial efficiency.

To conclude, Mr. Hodgson said, Malawi appeared to be back on the rails toward balance of payments sustainability, an objective that seemed realistic and attainable over the medium term, with continued adherence to the program and with some favorable developments in terms of export prices and external financing.

Mr. Salehkhou observed that despite the unfavorable international and regional economic environment in 1984, Malawi's adjustment effort had been remarkably successful during the second year of the program, which was supported by a three-year extended arrangement approved in September 1983. The U.S. dollar appreciation had added to the Government's burden of external interest payments and Malawi's access to its vital outlet to ports in Mozambique and limited transport routes had continued to deteriorate. But the balance of payments--particularly after debt relief--had improved substantially, recording a surplus of SDR 63 million compared with a deficit of SDR 43 million in 1983 and with the program target of a deficit equivalent to SDR 10 million. While domestic inflation had remained close to the projected level during the second year of the arrangement, real output had grown by 4.1 percent, well above the projected average annual rate of 3.5 percent. Such improvements were however attributable largely to the increase in agricultural output.

Compared with the previous year, gross official reserves had risen from the equivalent of 2 weeks of imports to 11 weeks of imports, Mr. Salehkhou continued. While export receipts had increased in both value and volume, the volume of imports had fallen largely due to higher domestic import prices following the depreciation of the kwacha, higher transportation costs, and the tighter allocation of foreign exchange for imports. The terms of trade were estimated to have improved by about 4 percent during 1984.

All in all, except for the implementation of some domestic financial policies, the Malawian Government had demonstrated its firm commitment to addressing the country's structural problems in an industrious manner, Mr. Salehkhou considered. Moreover, the coordination between the Fund and the World Bank and the complementary extended arrangement and structural adjustment loans represented a welcome joint effort.

As to policy measures and their implementation, Mr. Salehkhou went on, he had noted the Government's determination to contain domestic demand, increase production, keep wages relatively restrained, take steps to streamline and liberalize the pricing system, halt further deterioration of the financial performance of major public enterprises, pursue flexible interest and exchange rate policies, increase taxes, reduce subsidies, and above all, to provide incentives in order to substantially increase agricultural output. However, the authorities' efforts to monitor spending by individual ministries and departments and to control overall expenditures in order to reduce the budget deficit of the Central Government had met with less success. Due to the adverse impact of shortcomings in domestic fiscal policies, the significant rise of external interest payments, which had exceeded projections, and the unrealized capital inflows, which had been estimated rather optimistically, the midyear review of October/November 1984 had not been concluded, and purchases under the extended arrangement had been interrupted during 1984/85. Yet taking into account the overall strength of the Government's past performance, he was confident that the authorities would be able to effectively implement the agreed measures outlined in their memorandum on economic and financial policies for 1985/86.

However, even taking into consideration the Malawian Government's comparatively good record of economic management, the overall economic and financial prospects for Malawi's medium-term domestic policies as well as external performance were likely to remain critically subject to exogenous factors, Mr. Salehkhou stated. Indeed, the medium-term outlook would not be favorable unless there was a significant improvement in the terms of trade, the external transport situation, the response of the international community to Malawi's need for concessionary assistance, and continued determination on the part of the authorities to complete successfully the intended economic and financial adjustment under the programs supported by the extended arrangement and the expected structural adjustment loan, leading toward a viable recovery and sustainable growth.

He concurred broadly with the thrust of the staff analysis and appraisal, and supported the proposed decision concluding the 1985 Article IV consultation, Mr. Salehkhou said. However, on the decision relating to the review under the extended arrangement, he asked what justification and precedents there were for reducing the previously agreed amount of the arrangement. The matter was especially important because Malawi had the only token extended arrangement with the Fund in place in Africa. It would be unfortunate to set a precedent that gave the wrong signal to potential users of Fund resources on the African continent. Also, would the procedure leading to the reduction in the size of the arrangement be applied to all similar cases in the future?

The staff representative from the African Department recalled that, during previous discussions in the Board of the extended arrangement with Malawi, expenditure control had always been seen as the chief weakness. During the past two years, the staff had tried to work extremely closely with the Malawian authorities, giving them the tools to monitor expenditures carefully and persuading them to use them and at the same time bring expenditures under better control. Inevitably, in reporting promptly after the end of the month, mistakes and double counting could occur, but he saw no alternative to collecting data on a regular basis if expenditures were to be monitored, as the authorities themselves recognized. The request for the submission of data on a monthly basis was intended to provide a signal, for consultation between the Malawian authorities and the staff and the Managing Director, in case that should be necessary; the data did not have the force of performance criteria. It should be noted that expenditures had been greatly in excess of the program targets over the past two years, to some extent because those targets had been set rather low, particularly for recurrent expenditures. More realistic targets had been set in the 1985/86 program, so that a better basis had been laid for controlling expenditures, and it should be possible for the authorities to observe the expenditure targets.

The very limited scope remaining under the program to reduce expenditures had left little alternative to export taxes, which were of course not an ideal form of taxation, the staff representative continued. Import taxes and income taxes were already high, and the intention had been to broaden the tax base, extending it to cover the agricultural sector, which generally escaped taxation. In the event, the export tax had been limited to tobacco and tea, and the tax base had not been broadened as much as the staff had hoped. Nevertheless, tobacco and tea accounted for the bulk of exports. The relatively low rate of export taxation should not have a major impact on export incentives. If there were to be any adverse impact on incentives to produce tea and tobacco, farmers might be persuaded to diversify into other crops, thereby perhaps contributing to export diversification, a much needed development in Malawi.

The rate of growth of GDP under the program in relation to the growth of imports might be somewhat lower than the Malawian authorities themselves would like to achieve, the staff representative explained. However, the increase in production incentives resulting from both increases in producer prices and the liberalization of prices generally had led to a remarkable growth of GNP in 1983 and 1984. Thus, the continuation of such incentives should make it possible to attain a reasonable rate of growth of GNP with the programmed growth of imports.

The slow rate of growth of sales of maize by ADMARC, the marketing agency, reflected for the most part the exceptionally good crop in 1984, which had enabled farmers to meet their own demand for maize, the staff representative noted. Domestic sales of maize, which were made below cost, had offset ADMARC's considerable profits on its export sales in 1984. The references in the staff report to the cross-subsidization of ADMARC sales had been designed to indicate the importance of pricing policy, a primary concern of the World Bank, which had considerable expertise in parastatal enterprises and related project loans. From the Fund's point of view, the Government's revenue problem made it extremely important to ensure that the parastatal enterprises, including ADMARC and the electricity authority, had sufficient operating surpluses to meet their financial needs.

The Government's contribution to the fertilizer fund had doubled simply because there had been a deficiency in the revolving fertilizer fund during 1984/85, the staff representative remarked. The letter of intent contained a commitment to reduce the subsidy element in the 1986/87 budget--reflecting 1985/86 fertilizer prices--to MK 4 million, approximately half that in the 1985/86 budget.

The relationship between current expenditures and development expenditures was not a close one, the staff representative commented. The current expenditures programmed for 1985/86 were realistic. It should also be possible, but not of course easy, for expenditure on personnel to be reduced; the Government had committed itself to considering such a reduction when it had received a report being prepared by the Civil Service Commission. The staff had in fact suggested to the Malawian authorities that they raise the amount of domestic counterpart funds to permit adequate use of development expenditure and foreign loans, and the budget did make sufficient allowance for such counterpart funds.

Under Malawi's exchange rate system, the rate of the kwacha was tied to a basket of currencies, making it possible for the authorities to change the weight of a particular currency depending on developments in exchange markets and domestic inflation, the staff representative said. The staff believed that the authorities should allow the exchange rate to slide to avoid any deterioration in competitiveness. Unfortunately, they had not done so during 1984, but their commitment to a more flexible exchange rate policy should make it possible to achieve that objective in 1985.

The medium-term balance of payments outlook would require Malawi to control the growth of imports tightly, the staff representative from the African Department stated. Therefore, it would be prudent for Malawi to be able to make further use of Fund resources following the conclusion of the extended arrangement, if developments on world markets became adverse.

The Deputy Director of the Exchange and Trade Relations Department noted that, in view of the seven months' delay in reactivating the program supported by the extended arrangement with Malawi, access during the remaining period of the arrangement--without any reduction in the amount--would have been equivalent to 141 percent of quota. That would have been too high and hard to rationalize in the context of Malawi's balance of payments need. The options considered by the staff had included the possibility of extending the arrangement period, as had been done for a number of stand-by arrangements, thereby stretching out access and adjustment over a longer time span. However, the decision establishing the extended Fund facility stated that an extended arrangement should be for not more than three years. Another option that had been considered was cancellation of the extended arrangement and its replacement by a new arrangement, under which access would in all likelihood be considerably reduced compared with the original extended arrangement. The staff and management had however been impressed by the strength of the measures that the Malawian authorities were either taking or planning to take under the extended arrangement as well as by their intention to carry forward the structural changes planned.

In further considering the case, two precedents had guided the staff, the Deputy Director added. First, there had been a lengthy delay in reaching agreement in 1984 on the second-year program under a two-year stand-by arrangement with Uruguay. In that case it had been proposed that access be reduced from 166 percent to 88 percent on a pro rata basis for the period of interruption. Second, under a three-year arrangement with Romania, the program had remained inoperative for one year. When the arrangement was reactivated, the undrawn balance scheduled during those 12 months had not been made available. The staff had recommended reducing Malawi's access on a pro rata basis for the period of the interruption.

In explaining the arithmetical procedure used to arrive at the recommended access, the Deputy Director noted that total access under the original program had been SDR 100 million; that amount had been divided by 36--the three years covered by the arrangement--and multiplied by 7--the months of interruption in the program; the reduction derived was thus SDR 19 million. The procedure applied did not establish a new policy. Whenever there were lengthy interruptions in multiyear arrangements, the staff presented to management and to the Executive Board what seemed to be the most reasonable and justifiable approach in the circumstances. There had been cases in the past of access not having been reduced when programs had become inactive for certain periods, an experience that the staff would not necessarily wish to repeat. The Executive Board could rest assured that the staff was not setting new policy but adapting existing practices, as it would continue to do in future, on a case-by-case basis.

In response to further questions, the Deputy Director observed that the problem of the overhang of purchases in interrupted multiyear arrangements had arisen ever since the onset of extended arrangements and multiyear stand-by arrangements. There had never been any presumption that purchases not made during interrupted programs should automatically be made available when arrangements were reactivated. When an arrangement was interrupted because of failure to meet performance tests or other requirements, and if the program could not be brought back on track, the program was normally canceled, whether it was supported by a one-year or multiyear stand-by arrangement or by an extended arrangement. If the program could be brought back on track, the member's access was considered, based on both cause and duration of the nonperformance. There might be no need to recommend changing the amount of access if the interruption had lasted for a relatively short period; seven months was a long period, calling for serious reconsideration of the amount of access. Even with the proposed reduction, average access in support of the Malawian program, spread over three years, was on the high side, at about 73 percent of quota, compared with arrangements in support of other programs recently approved by the Executive Board. In addition, at the end of the three-year program period, Malawi's outstanding purchases would reach 359 percent of quota, including purchases under the special facilities, and about 300 percent excluding those latter purchases. Relatively few members had reached such high limits of access to Fund resources. The reduction recommended in Malawi's access had taken into account all the considerations he had mentioned.

Malawi's access was high in two respects, the Deputy Director of the Exchange and Trade Relations Department explained. First, use of Fund resources presently exceeded or would exceed 300 percent of quota, if purchases under existing arrangements proceeded as scheduled, for only seven member countries. Second, Malawi's access was high in terms of its debt servicing capacity. It was essential to bear constantly in mind the need to consider access by individual member countries in the context not only of general Fund policies but in order to avoid putting any country in the position of owing a major part of its debt to the Fund.

Mr. Vasudevan said that he had been reassured by the staff representative's clarification that the monthly monitoring of data was a limit rather than a performance criterion, especially as the possibility of consultation with the Managing Director had been mentioned in connection with performance criteria in Section IV-6 of the staff report. His own experience suggested that there was no reliable forecasting technique for setting limits on monthly expenditures, in the sense that, if a particular limit was exceeded in a particular month, the authorities would be expected to consult the Fund.

The way in which the money supply growth in overall terms was calculated also seemed technically deficient, Mr. Vasudevan observed. The point made by Mr. Clark and Mr. Hodgson was important in that respect, namely, what type of instruments did the authorities have to sterilize monetary growth resulting from external inflows?

Mr. Dallara remarked that he continued to feel that there might be some additional scope for reducing current expenditure, although he had been somewhat reassured by the staff representative's comments about the possibility that the export levy might not have an adverse effect on exports. Current expenditure for 1983/84 had originally been programmed at MK 272 million, and the actual outturn had been MK 297 million; the programmed and actual estimated outturn in 1984/85 of MK 323 million and MK 360 million, respectively, showed a large increase. As he understood it, the original program targets had been too ambitious, possibly in light of the monitoring problem. It would be unfortunate if more serious underlying policy limitations were to deprive Malawi of the growth that it might otherwise achieve if it did not have to reduce expenditure in the effort to adjust the balance of payments.

He had been pleased to learn that the reduction in access did not reflect a new policy, Mr. Dallara commented. As a matter of fact, the annual rate of access implied in the revised arrangement was larger than for virtually any arrangement that had been brought before the Executive Board recently. The actual access would be higher than 100 percent of quota calculated on an annual basis that did not leave out the seven months of interrupted performance.

The staff representative from the African Department noted that it was difficult to find instruments for the sterilization of money in the absence of well-developed capital markets. Malawi did have a well-established market for government securities, and the discussions with the Reserve Bank of Malawi, as the memorandum on economic and financial policies showed, indicated a readiness on the part of the Malawian authorities to issue Reserve Bank stock. It was not a perfect instrument, but it was the only one available and, if it was used more vigorously, would lead to the development of a capital market.

It was not possible to program a constantly high rate of development expenditure and low rate of recurrent expenditure, the staff representative commented, because the recurrent expenditure needed to efficiently utilize and maintain capital investment had to rise with the development budget. An attempt had been made in the program to set a reasonable relationship between those two components of government expenditure. No doubt there were areas in which government expenditure, on both the development and perhaps on the recurrent side, could be reduced. But the most reasonable program of expenditure and revenue on which agreement could be reached had had to be based on judgment, taking account of noneconomic factors.

On the difficult issue of monetary growth, he did not pretend to be able to point to any particular techniques of calculation, the staff representative from the African Department concluded. However, the program did aim at containing demand, taking into account likely balance of payments developments and the legitimate credit requirements of the private sector.

Mr. Vasudevan remarked that he had not been convinced by the staff argument but would not take the point further.

Mr. Salehkhou remarked that he too had not been convinced by the criteria mentioned by the staff for arriving at the decision to reduce Malawi's access. The precedents of Uruguay and Romania might not be valid, if the reduction of their access had coincided with the decision of the Executive Board to reduce access in general. He recalled several interruptions to programs since that time that had not led to any reduction in access or rephasing of purchases. An adjustment program supported by a Fund arrangement was a contract between the Fund and the member. Once the access limit was agreed, the member counted on receiving the resources to be made available and shaped its economic program accordingly. The very decision to reduce access would bring about an interruption in the program. He expected that that justification would be provided in future, in addition to elements of judgment by the staff, if any such reductions in access were considered appropriate.

Mr. Abdallah said that he had been glad that so many important issues, including that of the reduction in access and the way in which it had been calculated, as well as other technical issues, had been raised. He hoped that the staff would reflect further upon them so that a more suitable approach could be taken in future.

The transport difficulties of Malawi were likely to be less severe in 1985 and 1986, Mr. Abdallah stated, because the European Communities had been working with Malawi and Tanzania in an effort to improve access to the northern route through Dar es Salaam, which would be a very helpful outlet for Malawi. Second, if the route through Mozambique could be stabilized by even a little, transport costs would be reduced.

The scope for cutbacks in recurrent expenditure was almost negligible, Mr. Abdallah observed. The Malawian authorities had a system in place for effecting expenditure control, once they were convinced that that was necessary, and he was convinced both that they were and that they could control expenditure. However, he suggested that the staff be patient because the requirement for the prompt provision of data at the end of every month might divert the energies of those who were concerned with controlling expenditure to dealing with statistical issues. It was more important to watch the trend of expenditures, perhaps every two months, and at other important times. Some of the expenditures in question were seasonal or not of predictable regularity, and it was therefore difficult to program them precisely for any given month.

Great improvements had been recorded in the functioning of the parastatal sector, Mr. Abdallah noted. The enterprise responsible for maize had done extremely well, the demand for maize in neighboring countries having been brisk; the failure to export had, he understood, been a matter of concern about prompt payment.

Finally, Mr. Abdallah remarked, landlocked countries facing a myriad of problems should be shown somewhat more understanding. Much would also depend on the weather: Malawi's program might well be on track, but drought could set it back in the opposite direction.

The staff representative from the African Department, in response to a request by the Acting Chairman, noted that there was no intention to react instantly to monthly data by calling for consultations with the Fund. The staff had been attempting to find supplementary monitoring criteria that were intended to be forward looking and that would enable the Malawian authorities to predict whether any policy adjustments were needed, either on the revenue side or on the expenditure side. As Executive Directors had recognized, the data would be subject to considerable variability and the criteria for judging their seasonality were very weak. Similar arrangements were currently in use in other member countries, for instance, in Madagascar, Mauritius, and Morocco. The uncertainty surrounding the preliminary expenditure figures received on the previous day from Malawi had given rise to fears that had probably not been justified. The staff had felt obliged to bring the figures to the attention of the Executive Board because, if those end-year figures had been verified, they would have brought into question the program for 1985/86. It might perhaps be noted that the monthly data that had been submitted should have been received three weeks previously.

Finally, the staff representative from the African Department reiterated that the monthly control and monitoring of expenditure was a necessary exercise for the Malawian authorities. The Fund would shortly be sending a member of the fiscal panel of the Fiscal Affairs Department to Malawi who should be of assistance to the authorities in conducting the exercise.

The Acting Chairman made the following summing up:

> Executive Directors broadly agreed with the views expressed in the staff report for the 1985 Article IV consultation and for the review under the extended arrangement. Directors noted that despite the continuing problems affecting Malawi's traditional trade routes, favorable external conditions had resulted in a large overall external surplus, thus reversing the deterioration of the previous year, and also mitigating the effects of shortcomings in domestic financial policies. The terms of trade improved and imports continued to remain at a low level. The sharp increase in net domestic savings in 1984 was also welcomed. Directors observed that the improved external position had been promoted by continuing strong real economic growth, particularly in the smallholder agricultural sector, whose marketed output had responded well to improved incentives. The authorities were urged to implement further increases in the real incentives for agricultural production to further stimulate the production of commodities with a high net export-earning or import-substituting potential. In that connection, the need for export diversification was also strongly emphasized by Directors.
>
> Directors noted with concern the persistent difficulty of keeping government expenditure within programmed limits in the preceding two fiscal years covered by the extended arrangement,

particularly in the area of recurrent spending, where significant overruns had again occurred in most categories, including that of personal emoluments. Directors also welcomed the authorities' intention of achieving a substantial reduction in the Central Government's deficit relative to GDP in 1985/86, but stressed that it could be realized only if supported by a firmer monitoring and control over expenditure than had been achieved previously. Similarly, the question was raised whether the forecast large increase in government revenue was fully realistic, and the authorities were encouraged to take measures in that respect to broaden the tax base. At the same time, concern was expressed at the use of export levies as a means of generating revenues. The program's medium-term objectives would be jeopardized unless the Government was able to reduce its overall deficit further, particularly by restricting wage expenditure tightly, reducing subsidies, and developing a realistic investment strategy. Directors also urged that strong and determined action be taken to improve the financial performance of the state enterprises; it was suggested that the World Bank might be of assistance in that connection. Public sector investment should concentrate on high-yielding projects and make adequate provision for promoting the productive sectors of the economy.

Directors stressed the need for closer surveillance of monetary developments in view of the unanticipated growth of bank liquidity that had occurred during 1984.

Executive Directors welcomed the authorities' intention to achieve the original objectives of the extended arrangement, despite the slippage in financial policies that had occurred in 1984/85, and they noted favorably the strong and determined policy measures implemented toward that end. They observed that many of the exogenous factors that had led to the unexpectedly strong external position in 1984 were unlikely to continue in 1985 or in subsequent years, and thus stressed the need for appropriate domestic financial policies to ensure the sustainability of the medium-term balance of payments. In this regard, Directors welcomed the substantial strengthening of policies already implemented in 1985, including the adjustment of the exchange rate, the change in the structure of interest rates to positive rates in real terms, the intention to eliminate price control by the end of the year, and a budget designed to further reduce the Central Government's recourse to domestic financing. In the view of many Directors, the high burden of external debt underscored the need to maintain external competitiveness. Directors also noted the authorities' intention to avoid further debt rescheduling and to seek further external financing through the medium of a Consultative Group under the auspices of the World Bank, together with a third structural adjustment loan. They also noted Malawi's continuing dependence on inflows of concessional aid. Directors urged Malawi to continue addressing its structural problems flexibly and to stay on the path of sustained adjustment in order to strengthen the viabilty of the external position.

It was proposed that the next Article IV consultation with Malawi should be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding 1985 Article XIV Consultation

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

2. Malawi continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, Section 2, as described in SM/85/121. The Fund notes that Malawi's exchange system is administered in a flexible manner.

Decision No. 7980-(85/77), adopted
May 22, 1985

Review Under Extended Arrangement

1. Malawi has consulted with the Fund in accordance with paragraph 4(c) of the extended arrangement for Malawi and paragraph 31 of the memorandum attached to the letter from the Minister of Finance and the Governor of the Reserve Bank of Malawi dated June 25, 1984, attached to the extended arrangement for Malawi (EBS/83/183, Sup. 1, 8/26/83; and EBS/84/151, 7/12/84), in order to reach understandings with the Fund regarding policies and measures that Malawi will pursue through March 31, 1986.

2. The letter dated April 12, 1985 from the Minister of Finance and the Governor of the Reserve Bank of Malawi, together with an accompanying Economic Policy Memorandum, shall be attached to the extended arrangement for Malawi, and the letter dated July 29, 1983, together with the accompanying Economic Policy Memorandum, shall be read as supplemented by the letter dated April 12, 1985 together with the accompanying Economic Policy Memorandum.

3. Malawi will not make purchases under the extended arrangement that would increase the Fund's holdings of Malawi's currency in the credit tranches beyond 25 percent of quota or

increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the ceiling on the net domestic assets of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or

(ii) the ceiling on the net credit to the Government of the banking system as specified in paragraphs 24 and 25 of the Memorandum attached to the letter dated April 12, 1985, or

(iii) the limit on external borrowing as specified in paragraph 10 of the Memorandum attached to the letter dated April 12, 1985,

has not been observed; or

(b) during any period after December 31, 1985, until the review with the Fund contemplated in paragraph 33 of the Memorandum attached to the letter dated April 12, 1985 has been completed, or, following that review, while any performance criteria established by the Fund pursuant to the review are not observed.

4. The extended arrangement shall be amended as follows:

(a) In paragraph 1, replace "SDR 100 million" with "SDR 81 million."

(b) In paragraph 2(b), replace "April 30, 1985" with "May 31, 1985," and "SDR 47 million" with "SDR 34 million."

(c) In paragraph 2(c), replace "April 30, 1986" with "May 15, 1986," and "SDR 83 million" with "SDR 65 million."

(d) In paragraph 2(d), replace "April 30, 1985" with "May 31, 1985," and "April 30, 1986" with "May 15, 1986."

(e) In paragraph 4(c), replace "April 29, 1985" with "May 30, 1985," and "April 29, 1986" with "May 14, 1986."

(f) At the end of paragraph 4 add the following as paragraph 4(e): "Malawi will not make purchases under this extended arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action with respect to a noncomplying purchase."

5. Until May 15, 1986, purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 65 million provided that purchases shall not exceed the equivalent of SDR 41 million until August 15, 1985, the equivalent of SDR 49 million until November 15, 1985, and the equivalent of SDR 57 million until February 15, 1986.

Decision No. 7981-(85/77), adopted
May 22, 1985

2. GHANA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the first review under the stand-by arrangement for Ghana (EBS/85/110, 5/1/85).

The staff representative from the African Department noted that in accordance with paragraph 5 of the Ghanaian authorities' letter of intent, the higher cocoa producer price for the 1985/86 crop year--and also for the small midseason before the middle of 1985--had been announced on May 16, 1985. The new price would go a long way to re-establish incentives. The World Bank staff considered that the price increase was sufficient to provide incentives for the harvesting of cocoa under cultivation at present and also for the rehabilitation of cocoa acreage, although it might not yet be enough to encourage new planting. By the 1986/87 crop season, the producer price for cocoa should be sufficient to provide incentives for replanting as well.

The performance criteria for March had been met, the staff representative from the African Department commented. Total net domestic assets outstanding had been slightly below the ceiling, as had net claims on the Government. Ghana had once more exceeded its obligation to reduce external arrears, which were to have been reduced by $45 million on a cumulative basis since the beginning of the program; by the end of March, they had been reduced by $50.4 million. The performance criterion relating to the contracting of new loans had also been met.

Mr. Salehkhou made the following statement:

The Ghanaian authorities are in full agreement with the main elements of the analysis and conclusion presented in the staff paper.

The current stand-by program, which is due to expire at the end of this year, is a comprehensive one that aims at consolidating the gains that accrued after the bold initial steps were taken in 1983 toward correction of the serious imbalances in the economy. In addition, the program aims at accelerating economic growth and achieving medium-term balance of payments viability through further rehabilitation of the export sector, regular supervision over relative prices, further restructuring of public enterprises, rebuilding and renovation of the productive infrastructure, and maintaining a competitive exchange rate.

The data available for the calendar year 1984 are very encouraging, although prospects for continued flows of external financing--an essential ingredient in any effective economic blueprint for sub-Saharan developing countries--are not favorable.

Real gross domestic product grew by 7.6 percent, significantly reversing the declining trend of the previous five years. The considerable acceleration in economic growth was reflected mainly in agricultural production. Manufacturing production took advantage of the greater imported inputs and the gradual rehabilitation of essential infrastructure, from which the agricultural sector also benefited owing to better road conditions, transport and port facilities, and the relative easing of other associated bottlenecks. The sharp rise in agricultural production was also noticeably related to favorable weather conditions as well as the existence of more realistic pricing policies especially with regard to cocoa, timber, and maize, as well as other products.

In full recognition of the importance of maintaining flexible pricing policies and the interaction of market forces, the authorities last week revised the cocoa producer price for the 1985/86 crop year, reflecting an increase of 89 percent over its existing level. Other controlled prices will also be managed more flexibly with due regard to cost and profit margins. The aim is that with the gradual improvement in the supply situation and the availability of more products and commodities, the few remaining controlled items will be decontrolled, thereby allowing for the full interplay of market forces.

The deceleration of inflation during 1984 was noticeable, although it was partly due to a bumper harvest, which limited the rise in food prices to only 11 percent, as against a general cost of living increase of 40 percent, compared with 123 percent in 1983. The currency depreciation and other price adjustments caused other consumer prices to rise by 80 percent. The prospects for continued deceleration of inflation are encouraging and the inflation objective in 1985, depending on normal weather conditions, is to lower the rate to about 20 percent. Inflationary expectations, however, are harder to control and depend importantly on the basic economic forces that operate in an economy dependent on essential imports and undiversified agricultural exports. The authorities are fully aware that there is little room for complacency and, for several years to come, the anti-inflationary efforts would be closely harmonized and monitored pending the gradual correction of the remaining economic imbalances and the maintenance of external flows. Closely connected to this issue, the adjustment of wages and salaries in the government sector by 89 percent on average in 1984 sought to restore partially the serious erosion in the purchasing power of the civil servants, which is still less than half its level of 1978. To retain talented civil servants and to maintain their morale, further ad hoc increases in wages and salaries may be granted pending the availability of revenue sources, but no further general wage increases are contemplated for 1985.

Fiscal developments in 1984 have been, on the whole, satisfactory, with the fiscal deficit narrowing to 1.5 percent of GDP, against a budgeted ratio of 1.8 percent. The shortfall in tax revenue was compensated for by the more effective enforcement of the income tax, greater collection of cocoa export levy duties, higher excise duties on cigarettes, and other revenue-boosting measures.

In order to comply with the financial program and the credit limits, and in light of a shortfall in concessional foreign financing, the authorities reduced capital expenditures and limited recurrent expenditures. The 1985 budget maintains the cautious fiscal stance and at the same time earmarks an increased allocation for capital expenditure in view of the urgent need to tackle the infrastructural problems. On the revenue side, improvements are envisaged in tax administration, and there are provisions for increases in excise duties on alcoholic beverages and cigarettes, registration fees, as well as other domestic resource mobilization measures.

During 1984 credit expansion was limited, with the rise in the overall net domestic assets duly reflecting the currency depreciation and the increased level of economic activities. Similarly, the performance criteria on credit for 1985 reflects the seasonality in cocoa financing and the timing of external resource disbursements. The general stance of the monetary and credit policies, in recognition of the economic achievements so far and with due consideration for the continued need for inflation monitoring, is quite cautious, and the authorities stand ready to take supplementary measures in case of any unforeseen slippages.

A credit expansion of ₵ 12.6 billion is planned for 1985, of which government borrowing would be limited to ₵ 2 billion. Some one fifth of this amount will be allocated to cocoa crop financing, while about two thirds will be allocated to the needs of the private sector, and public enterprises. This shows the authorities' determination to further invigorate the business sector, particularly the agriculture and mining sectors.

The balance of payments performance during 1984 has been mixed, with export values rising by nearly 30 percent over 1983 and imports rising slightly, but falling significantly short of the original estimate. The latter strikes an ominous note as it adversely affects much needed capital investments and the requirements of industry and agriculture for imported capital and intermediate goods.

The rise in exports should be viewed in light of an increase in cocoa unit prices in international markets, which were 50 percent higher in 1984. In terms of volume, cocoa exports actually fell, a development which clearly shows the susceptibility of Ghana's exports to changes in international commodity prices. Among the other export products, timber, manganese, and gold benefited from infrastructural improvements and increased production, although much remains to be done to effectively rehabilitate the export sector. These developments, while noteworthy, also point to the fragility of the structure of Ghana's foreign trade and the urgent need for an overhaul of the basic economic elements that directly affect the foreign trade sector. Uncertainty regarding the timing of capital inflows has adversely affected national planning and management of foreign trade programs. Despite such problems, however, the authorities reduced arrears by $70 million in 1984 and further significant reductions in 1985 are envisaged.

Since the inception of the stand-by program with the Fund in 1983, total outstanding arrears have fallen from $439.5 million at the end of 1983 to a projected $171.7 million at the end of 1985. Yet, at the same time, total external medium- and long-term debt has risen from 12.4 percent of GDP to a projected 20.7 percent during the same period. Accordingly, debt service payments as a proportion of merchandise exports are estimated to exceed 50 percent by the end of 1985. This development underscores the need for continuous concessional and nondebt-creating flows to Ghana.

The World Bank Group's activities in Ghana have considerably increased since the inception of the stand-by program in 1983. In recent years and mostly prior to the start of the major economic adjustment currently being implemented, the country's economic difficulties adversely affected a number of Bank Group-financed projects. Such problems included shortage of government revenues to cover local currency financing, shortage of skilled manpower and productivity, lack of imported materials and spare parts mainly as a result of the lack of foreign exchange, and infrastructural problems. Implementation of World Bank projects during the post-1983 period had initially encountered other problems including unforeseen delays as a result of economic hardship, and drought-related bottlenecks that caused delays in project implementation. These problems, however, are being speedily addressed as a result of the introduction of the recent adjustment programs, in close consultation with the Fund and the World Bank.

In addition to the World Bank-related projects detailed in Appendix IV of the staff report, the International Finance Corporation (IFC) approved an investment of $55 million in the mining sector (Ashanti Goldfields Corporation) in June 1984. This is the IFC's first investment in Ghana and will help increase gold output in that region. The project has attracted private bank cofinancing for the first time in many years, which reflects the growing confidence by the commercial lending agencies in the management of Ghana's economy. In addition, the Accra District Rehabilitation Project and the Second Reconstruction Import Credit were both approved in March 1985. While the former has already become effective, the latter project, whose major condition--the adjustment of cocoa producer price-was fulfilled last week, is expected to become effective in the near future.

The year 1985 is a crucial one for Ghana. It is essential that, in view of the tremendous efforts and sacrifices shown so far by the authorities and the people of Ghana toward economic recovery and long-term viability, the international financial community, in acknowledgment of such efforts, fully facilitate the flow of concessional resources to Ghana and help with their adjustment program.

Mr. Taha said that he agreed with the main points in the staff appraisal and that he supported the proposed decision. The information provided by the staff representative with respect to the fulfillment of the performance criteria for end-March was gratifying. Indeed, in recent years, the Ghanaian authorities had successfully implemented far-reaching reforms in key policy areas. Those reforms had been designed to reduce financial imbalances and to rebuild the economy's productive capacity, as well as to improve resource allocation in general. As a result of those measures and of favorable weather, output was picking up, inflation had declined sharply, and the budget and external position had improved.

But those impressive achievements needed to be sustained to restore domestic and external confidence, Mr. Taha observed. In particular, there was an urgent need to continue to reduce inflation, in line with the 1985 program, as well as to maintain real economic growth at about 5 percent and to strengthen the balance of payments. The realization of those objectives would require firm financial policies, flexible domestic pricing policies, and a flexible exchange rate strategy.

The program appropriately emphasized the need to generate additional domestic resources to finance higher development expenditures without intensifying inflationary pressures, Mr. Taha continued. Thus, he welcomed the authorities' intention to boost revenue, but the growth in current expenditures would have to be closely monitored and controlled. It would be useful to learn more about the capital outlays projected in the 1985 budget, which were apparently expected to almost double. In addition, cautious monetary and credit policies, if they were successfully maintained, should facilitate the mobilization of additional domestic savings and help to channel credit to productive sectors.

The flexible exchange rate policy and the parallel adjustment in producer prices had had a favorable impact on Ghana's domestic output, on exports, and on international competitiveness, Mr. Taha observed. But until the rate of inflation was brought down further, both the exchange rate and producer prices would have to be adjusted regularly to maintain, and indeed to improve, production incentives and export competitiveness. Looking ahead, it was clear that Ghana's medium-term prospects would depend critically upon further expansion of exports and adequate inflows of foreign capital on concessional terms. As the staff had indicated, the adjustment effort needed to be complemented by the rehabilitation of productive and infrastructural capacity as well as by reform of the administration; good progress had been made in those areas in the past couple of years. He encouraged the authorities to continue their present policies so as to sustain Ghana's economic recovery over the medium term. Finally, it would be helpful to have staff comment on the prospects for putting a carefully planned investment program in place and on the likely extent of World Bank involvement.

Mr. Finaish recalled that in 1983 Ghana had launched a major effort of economic stabilization and rehabilitation, with the overall objective of restoring a sound economic and financial basis for growth in the context of medium-term balance of payments viability. In continuation of that adjustment effort, the successful completion of a stand-by arrangement in 1984 had been followed by the adoption of the program under review, which had also been kept on track. The outcome for 1984 showed that the measures undertaken so far had started to pay off in terms of improved economic performance. In particular, real GDP growth had picked up significantly after a few years of continuous decline and the rate of inflation had been sharply reduced. Notwithstanding the seriousness of Ghana's remaining problems, the authorities' determined commitment to economic adjustment was cause for optimism about the continuation and strengthening of the incipient recovery in the period ahead.

Ghana's economic recovery program had placed particular emphasis on restructuring relative prices by means of appropriate exchange rate and pricing policies in order to improve external competitiveness and promote more efficient allocation of resources to the benefit of productive export sectors, Mr. Finaish observed. The exchange rate policy initially had envisaged maintaining the rate constant in real terms, but the series of adjustments in 1984 had brought about a real depreciation of 35 percent. The exchange rate was targeted for a further real depreciation of 20 percent in 1985; nevertheless the staff believed that "there are indications that the resulting real rate will still be overvalued...."

A further elaboration by the staff of those indications would be useful, taking into account that the current real effective exchange rate was the lowest since 1978, as Chart I showed.

The flexible exchange rate policy had continued to facilitate the upward adjustment of the cocoa producer price with a view to restoring and maintaining adequate production incentives, Mr. Finaish went on. Moreover, the process of price liberalization was scheduled to be virtually completed during 1985. To cushion the impact, a substantial wage increase in the public sector had been granted at the end of 1984 which however was not excessive since public sector wages remained below one quarter of the 1975 level in real terms. While the redeployment of redundant labor to productive sectors was necessary, the social cost and the impact of the wage policy on the functioning of the public sector needed to be taken into account. Therefore, it was encouraging to note that consideration was being given to selective salary adjustments to retain individuals with specific professional skills.

The fiscal outturn for 1984 had conformed closely to the targets in the adjustment program by virtue of the additional revenue-raising and expenditure-saving measures undertaken to compensate for the shortfall in tax revenues and net foreign financing, Mr. Finaish said. The 1985 budget provided for a slight increase in the overall budgeted fiscal deficit in terms of GDP. However, that increase reflected a higher level of concessional commodity assistance, and the budget would remain somewhat less expansionary than in 1984. Furthermore, two thirds of the deficit would be financed from foreign sources, and the authorities planned to take compensating measures if there were unexpected shortfalls so as to maintain the adequacy of credit to the private sector. Another important aspect of the 1985 budget was that it provided for a substantial increase in development outlays, permitting greater emphasis to be placed on eliminating transportation and other structural problems. At the same time, several measures to restrain the growth in recurrent expenditures and other measures to raise additional revenues had been implemented.

Monetary policy during 1984 had been generally satisfactory, Mr. Finaish remarked. The expansion of credit had remained under tight control throughout the year and the credit ceilings for both Government and the overall economy had been observed. Prudent monetary targets and credit ceilings had been set for 1985 that were consistent with the targeted substantial reductions in the rate of inflation and the overall balance of payments deficit. In addition, the process of making interest rates positive in real terms had continued, and should promote both domestic savings and the more efficient allocation of financial resources.

The balance of payments outcome for 1984 had differed significantly from earlier projections, due largely to lower than expected imports, Mr. Finaish commented. The significant rise targeted for imports had not materialized owing to a shortfall in official capital inflows. In view of the heavy reliance of the productive sectors in Ghana on imported intermediate and capital goods, however, a significant expansion of imports was fortunately programmed for 1985. The current account deficit in 1985 would increase as a result, but the overall balance of payments deficit was expected to be cut by one half, mainly by virtue of the projection of a strong export performance and higher official capital inflows.

The major adjustment efforts launched by the Ghanaian authorities, in close cooperation with both the Fund and the World Bank, reflected commendable determination on their part, Mr. Finaish concluded. The medium-term scenario prepared by the staff showed the need for those efforts to be maintained for a number of years. The likely hardships could only be eased by an early recovery in Ghana's exports and increased assistance and concessionary loans. That was particularly true in light of the growing import requirements of the recovery and the rising debt service ratio, in addition to the importance attached by the authorities to continue to meet the programmed reductions in external arrears. He supported the proposed decision.

Mr. Hodgson observed that when Ghana had begun its current adjustment efforts in 1983, the economy had suffered from four years of decline and from an even longer period of neglect. Widely recognized economic potential had been ignored--or even squandered--for far too long. Yet the staff report showed how quickly an economy could be turned around, given the right combination of natural resource endowment, favorable climatic developments, and political will.

Under the current program, Ghana had so far met or exceeded the performance criteria and program targets, Mr. Hodgson noted. Even more important, it had begun to establish the kind of economic framework that allowed aggregate demand to be regulated and permitted structural adjustment and stimulation of the supply side of the economy. The goal during the balance of the current stand-by arrangement must be to consolidate the macroeconomic gains, and at the same time strengthen the productive base through the rehabilitation of infrastructure, increased imports of capital goods, materials, and spare parts, and improved producer incentives. The 1985 adjustment program was consistent with those objectives.

He had no major difficulty with the authorities' fiscal plans for 1985, Mr. Hodgson continued. The large increases in development outlays and public sector salaries in 1985 would only partially compensate for insufficient action in those areas in preceding years. He had been particularly encouraged by the combination of a cap on the overall public service and an attempt to offer adequate compensation to retain qualified civil servants. The improved efficiency and rationalization of the Cocoa Marketing Board was also welcome, as was the reliance on external sources to finance two thirds of the projected deficit, which should channel more domestic credit to the private sector.

The authorities' commitment to exchange rate flexibility and to improved competitiveness was heartening, Mr. Hodgson added. Considerable--perhaps even radical--adjustment had already been undertaken and was beginning to bear fruit. Coupled with the authorities' commitment to price flexibility and to improved producer prices for cocoa, the further real devaluation of the cedi would be a valuable step toward medium-term balance of payments sustainability.

The projections provided by the staff for the medium-term balance of payments would require an unflagging commitment to the present course of policy if they were to be realized, Mr. Hodgson commented. The debt service ratio would remain in excess of 45 percent until 1988. Further, debt service to the Fund alone in 1987 and 1988 would be equal to almost 20 percent of foreign exchange earnings. It was necessary to remain mindful of that fact in considering the Fund's future role in Ghana, and to avoid taking any steps that would unduly aggravate the debt service burden.

As for monetary policy, Mr. Hodgson remarked, he could only hope that liquidity creation would be controlled as effectively in 1985 as it had been in 1984, when the prescribed ceilings had allowed the growth, balance of payments, and inflation targets to be met. He had been encouraged by the authorities' commitment to raise interest rates to real positive levels by June 1986, and by the recently announced increase in deposit rates, but wondered whether the schedule could be accelerated.

To conclude, Mr. Hodgson said that he saw no reason why Ghana could not maintain the remarkable progress achieved over the past two years under the 1985 program. He supported the proposed decision.

Mr. Clark observed that Ghana's adjustment program was beginning to bear fruit. He noted in particular the sharp increase in real GDP growth, which owed something to the weather, the reduction in inflation, the strengthening of macroeconomic policies, and the infrastructural improvements, where, however, more remained to be done. The favorable outcome of the Consultative Group meeting in December 1984 was a testimonial to the success of the Ghanaian authorities in keeping the program well on track.

It was equally encouraging to learn from the medium-term projections that it should be possible for Ghana to achieve a viable external position by the end of the decade, Mr. Clark remarked, although he wondered whether some of the staff's export assumptions were not somewhat optimistic. Whatever the medium-term position, difficult years would certainly intervene, and debt service payments--notably repayments to the Fund--would remain high until 1988. The adjustment effort would therefore clearly need to be sustained, which would be no easy task. The Fund was likely to have an essential role to play in Ghana for a number of years to come, but its credit was by no means concessional, and Ghana would have to avoid undue increases in its debt service burden. In that connection, the World Bank would play an increasingly important part both in mobilizing and providing resources.

The continued fiscal restraint embodied in the 1985 budget was welcome, Mr. Clark observed, as was the slightly reduced recourse to domestic bank financing. Also, he had been glad to note that the authorities had managed to find room for a substantial increase in capital expenditure.

As he had said in December, when the Executive Board had approved the Ghanaian authorities' request for a modification of the program and stand-by arrangement (EBS/84/243, 11/28/84, and Sup. 1, 11/30/84; EBM/84/172, 12/3/84), Mr. Clark recalled, the recent civil service wage increase had been necessary in order to reverse at least part of the very large reduction in real wages over the past ten years. Further selective increases might also be necessary to retain staff with special skills. However, given the still difficult economic situation, he was glad to note that the authorities did not intend to grant further increases for the remainder of 1985. He would be interested to learn from the staff whether there was any evidence of similar wage increases in the private sector.

The increase in the domestic savings ratio to 5 percent of GDP in 1984 was encouraging, Mr. Clark remarked. Nevertheless, it remained low compared with that in other African countries with similar per capita incomes, and he asked the staff what scope there was for raising it further.

The recovery in the agricultural sector in 1984 had been striking, Mr. Clark noted. Yet the particularly large maize harvest might reflect in part a movement by producers out of other commodities. He therefore welcomed the proposed real increase in cocoa producer prices, which should further restore producer incentives. The proposed rehabilitation of the cocoa sector was also welcome, but there were some indications that cocoa trees were not being replaced sufficiently quickly, and that their average age was therefore increasing. Perhaps the staff representative could follow up his brief comments on the subject at the beginning of the meeting and indicate whether those developments had any implications for the medium-term projections.

There were reports of increasing liquidity problems in enterprises, notably in the timber sector, as increasing cedi counterpart payments for imports under the rehabilitation program had to be made before the corresponding flows from increased exports came through, Mr. Clark observed. Again, staff comment would be helpful. He supported the proposed decision.

Ms. Lundsager observed that Ghana's satisfactory performance under the current stand-by arrangement was fully evident from the fact that targets and performance criteria were being met or even surpassed. While favorable exogenous events, such as better weather, had contributed to the good economic performance, policy changes, especially the increases in producer prices and the substantial depreciation of the cedi, were having positive effects on production and exports. The reduction in inflation, during a period when the cedi had depreciated significantly, was also noteworthy. Specific adjustment efforts in the various sectors appeared to be on track. As for the real economy, periodic increases in producer prices were increasing incentives, but the staff representative's comments about the need to increase areas under cultivation led her to urge a faster pace of adjustment of producer prices in the future.

The fiscal deficit had fallen and while it probably would be somewhat larger in 1985, due to higher than expected development spending, the increase was not unduly worrisome, thanks to the expected increase in foreign financing, Ms. Lundsager continued. During the discussion in December of the modification of the stand-by arrangement, her chair had noted that the large wage increase granted in 1984 had still left real wages in the public sector greatly below historic levels. Nonetheless, given the projected balance of payments financing gaps for the few years ahead, she had been reassured to learn that no further sector-wide wage increases would be granted in 1985. The more selective approach described in the staff paper, under which wage increases would be granted only to high-priority workers, was a more appropriate way of restructuring the civil service over the longer term. In that vein, she also supported the present freeze on government hiring and urged that reductions in the number of civil servants be effected as soon as possible. The authorities' plan to reduce the income tax burden created by inflationary bracket creep was also welcome.

It would be useful to know more about the actual and expected performance of the public enterprises, Ms. Lundsager commented. Subsidies on petroleum products had been eliminated, and mention was made on page 12 of EBS/85/110 of adjustments in tariffs and other charges. As there was no table on the consolidated public sector, and with transfers to public entities not being readily identifiable in Table 3 on central government operations, additional information on those entities would be welcome.

Monetary policy for 1985 appeared to be appropriately aimed at providing adequate expansion of credit to the private sector, Ms. Lundsager remarked. The pace at which interest rates were being increased, to bring them closer to positive real rates of return on savings, should be accelerated. Ghana's desire to speed up its development program necessitated stronger incentives to domestic saving in order to provide domestic resources for investment.

Exchange rate adjustments were proceeding as programmed, but it seemed clear from the staff analysis that further real depreciation was necessary, Ms. Lundsager observed. The rate for the cedi on the parallel market--which of course could not be considered the equilibrium rate--exceeded the official rate by a wide margin, indicating that the official rate remained too low. The lower than expected inflows of private transfers in 1984 might also indicate a need for more adjustment. Direct investment might respond more actively once the relative costs of operating in the Ghanaian economy had returned to competitive levels. Finally, further depreciation might permit additional liberalization of the import licensing scheme.

As for the medium-term outlook and the revitalized investment program, Ghana's imports had been scaled down in 1984 and not all the expected foreign financing had materialized, Ms. Lundsager commented. Commitments to take the same compensating steps again in 1985, if necessary, had been made. However, substantial financing gaps appeared likely from 1986 to

1988, even assuming large increases in exports. The authorities should therefore adjust their investment program and implement additional economic adjustment measures as needed, in line with the availability of financing. The extensive World Bank involvement in Ghana's development effort was welcome, and no doubt account had been taken of Ghana's absorptive capacity, yet it was equally important to secure full external financing. Her concern stemmed from the high debt servicing ratios facing Ghana as a result of past borrowing; while those ratios were projected to drop later in the decade, they could rise again if extensive reliance was placed on external borrowing to finance investment and the balance of payments. Furthermore, the high debt service payments due to the Fund in the few years ahead served as a reminder that Fund financing was neither long term nor concessional. Those reservations aside, her overall assessment of Ghanaian performance under its Fund-supported program was a positive one and she supported the proposed decision.

Mr. Doe stated that the satisfactory implementation of the current program thus far had built on the progress achieved under the 1983/84 program, leading to a marked improvement in the country's economic and financial situation. The additional information provided by the staff concerning the introduction of the increased cocoa producer prices for the 1985/86 season, the observance of the credit ceilings for end-March 1985, and the reduction beyond target of payments arrears were all welcome developments.

The long-awaited recovery that had emerged in 1984 followed three consecutive years of cumulative decline in total output of nearly 14 percent, Mr. Doe remarked. Real GDP had increased by almost 8 percent in 1984, reflecting a marked recovery in agricultural production due to better weather conditions and higher industrial activity as a result of the improved supply of imported inputs and of hydroelectric power. The pursuit of cautious fiscal and monetary policies, together with the improved food supply, had contributed to a significant abatement of inflationary pressures. The fiscal deficit had narrowed, from 2.3 percent of GDP in 1983 to 1.5 percent of GDP, well below the figure initially envisaged in the 1984 budget, owing largely to the impact of the tight control on current expenditure. In the external sector, the authorities had faithfully maintained their commitment to a flexible exchange rate policy. The overall balance of payments had registered a significant improvement as exports had expanded in 1984 by 29 percent relative to 1983, with noncocoa exports showing a better performance. Progress in reducing external payments arrears had also been stronger than expected.

All those positive signs were most encouraging, and he urged the Ghanaian authorities to persevere with their adjustment effort in 1985, Mr. Doe added. In that connection, he endorsed the macroeconomic objective of a 5.3 percent increase in real GDP, with a further expansion in agricultural output, and welcomed the intention to provide adequate incentives to producers. The aim of achieving a further decline in inflation to an annual average rate of 20 percent was also in the right direction, in the context of the agreed monetary targets and the projected outturn of the overall balance of payments.

Although the Ghanaian authorities had shown flexibility in formulating and implementing policy in the past, Mr. Doe went on, he encouraged them to reinforce their present policies in order to achieve a sustainable external position in a growth-oriented setting. A resolute effort should be made to execute successfully the rehabilitation programs for which the World Bank and other multilateral institutions had been providing technical and financial assistance.

With respect to the mobilization of private domestic savings, he endorsed the Ghanaian authorities' intention to implement a flexible interest rate policy with a view to improving the flow of savings in the economy, Mr. Doe said. That policy should be supplemented with steps to improve the overall environment for private saving and investment, particularly by strengthening confidence in the banking system.

Significant capital inflows were expected in 1985, in support of the development effort in general and the financing of economic projects in particular, Mr. Doe observed. In the past, delays in the disbursement of loans appeared to have hampered the implementation of some of the projects and the financing of some essential imports. It was therefore of paramount importance that cooperation between the Ghanaian authorities and foreign creditors as well as aid donors be strengthened in order to reduce, if not eliminate, those delays. In that connection, he had been pleased to note that some improvements had been made in import procedures; further streamlining of the import regime was necessary in order to improve resource allocation and economic efficiency.

The courageous measures introduced by the authorities over the past three years left him in no doubt about their continued determination to maintain the strength of the adjustment effort, Mr. Doe concluded. He associated himself with Mr. Salehkhou in calling on foreign aid donors and creditors to increase their concessional assistance to Ghana. He supported the proposed decision.

Mr. Abdallah stated that he was in broad agreement with the staff appraisal. He commended the Ghanaian authorities for their commitment to the adjustment process and for the sacrifices that the Ghanaian people had made. The program was structurally well conceived, placing as it did great emphasis on rehabilitating the economy rather than on simply trying to restrict demand to coincide with the low level of production. At the same time, it was an approach requiring the authorities to remain committed to the pursuit of appropriate domestic policies and the international community to support Ghana's strong efforts by extending adequate concessional aid. He hastened to add that the donor community appeared to be responding positively, as evidenced by its action at the second Consultative Group meeting held in December 1984.

The program depicted the need for some disequilibrium in the short run in order to attain the longer-term goals of sustained growth and a viable balance of payments position, Mr. Abdallah noted. From the inception of the program, it had been acknowledged that the external current account deficit would have to increase temporarily to accommodate the required level of inputs, without which the rehabilitation exercise would not be possible. The authorities however had sought to rely on concessional capital inflows in order to minimize the debt burden arising from the widening deficit.

The sharp increases in output in 1984 had been a welcome change after five years of decline, Mr. Abdallah continued. Agriculture--as a result of favorable weather--and manufacturing--in response to the greater availability of imported inputs--had performed well, but the mining and forestry sectors, which had great potential, had not performed as expected. The staff had related the problem in the mining sector to the shortage of both capital and skilled manpower; the former was expected to be ameliorated by the $158 million rehabilitation project of the Ashanti Goldfields Corporation. But he wondered what was being done to improve the availability of skilled manpower.

The decline in inflation from 123 percent in 1983 to less than 40 percent in 1984 was commendable, Mr. Abdallah remarked. However, the impact of price liberalization and of the continuous depreciation of the cedi might impede further progress.

He had noted that fiscal policy was expected to remain cautious in 1985, Mr. Abdallah went on. Particularly welcome efforts were being made to accommodate an increase in the development budget while keeping the deficit within reasonable limits. It was important that development expenditure should be geared toward removing transportation bottlenecks affecting the flow of exports. The efforts to keep the size of the civil service under control were also noteworthy.

The improvement in the current account of Ghana's balance of payments in 1984 had not been consistent with longer-term growth objectives, since it reflected almost entirely shortfalls in imports that would have been used to satisfy the needs of the productive sectors, Mr. Abdallah said. That development pointed to the need for steps to ensure the timely disbursement of financial aid.

The medium-term outlook for Ghana would depend greatly on the realization of three key assumptions, which unfortunately were outside the control of the authorities, Mr. Abdallah concluded. The first was that the environment underlying the recent world economic outlook survey would hold. The second was that the normal climatic conditions of the past year would prevail for the remainder of the decade. The third assumption was that sizable amounts of concessional aid would be forthcoming. Ghana's large debt service burden would keep the economy on a tightrope at least up to the end of the 1980s. The authorities seemed to be aware of the difficult circumstances in which they were operating, and they deserved international support. He supported the proposed decision.

Mr. Hammann stated that he was in broad agreement with the staff appraisal and that he could endorse the proposed decision. Ghana had continued to make progress under the current stand-by arrangement, as confirmed by the staff representative's statement.

He recalled that when the Executive Board had approved the stand-by arrangement for Ghana (EBM/84/128, 8/27/84), his chair had expressed concern about the projected widening of the gaps on external account, Mr. Hammann continued. The revised projections foresaw a much more favorable outcome, but he wondered whether there was not scope for further improvement. Ghana's debt service burden was rising rapidly in terms of merchandise exports, and the schedule for the repayment of external arrears would extend until the end of 1988. He recognized that once concerns over economic stabilization had become less acute, the transition from a predominantly belt-tightening approach to policies oriented more to the supply side seemed appropriate and indeed necessary, given the lack of essential importer inputs and the need to rehabilitate infrastructure. Nevertheless, he continued to be concerned that the pace envisaged for stepping up imports might be too ambitious. His concern was closely related to the envisaged doubling of development outlays mentioned by Mr. Taha and that might jeopardize the objective of reducing the inflation rate from 40 percent to 20 percent in 1985, especially bearing in mind the inflationary pressures to be expected as a result of further exchange rate adjustments. Those and other factors pointed to the need to maintain a restrictive monetary policy stance and to stimulate domestic saving.

Referring to the World Bank-sponsored three-country cement project, Mr. Hammann asked for additional information, first, on the future debt burden to be borne by Ghana for that apparently somewhat unfortunate project, and second, on the circumstances in which it might again become operative.

In concluding, Mr. Hammann said that he wished to strongly underline the staff recommendation that "...the authorities will need to stand ready to react flexibly and rapidly to any development that could threaten the thrust of the program."

Mr. Zhang stated that he supported the proposed decision.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/76 (5/20/85) and EBM/85/77 (5/22/85).

3. OPERATION OF FUND ACCOUNTS - AUTHORIZED SIGNATORIES

1. On and after May 21, 1985, the following officials of the International Monetary Fund are authorized to operate (i) the Fund's No. 1, securities and gold accounts held in the General Resources Account of the General Department; (ii) the cash and investment accounts held in the Special Disbursement Account of the General Department; (iii) the cash and investment accounts held in the Borrowed Resources Suspense Account in the General Department; (iv) the cash and investment accounts held in the Trust Fund Account; and (v) the cash and investment accounts held in the Supplementary Financing Facility Subsidy Account, as follows:

(a) The Managing Director together with the Deputy Managing Director, or either of them together with any one of the officers listed under (b) or (c) below.

(b) Any two of the following signatories, or any one of them together with any one of the signatories listed under (a) or (c):

(1) The Treasurer
(2) The Deputy Treasurers
(3) The Senior Advisor, Treasurer's Department
(4) The Advisors, Treasurer's Department
(5) The Assistant Treasurer for the Financial Relations Division
(6) The Assistant Treasurer for the Operations Division for General Resources
(7) The Chief of the Accounts and Financial Reports Division
(8) The Chief of the Administrative Expenditures Division
(9) The Chief of the Operations Division for SDRs and Administered Accounts

(c) Any one of the signatories listed under (a) or (b) together with any one of the following:

(1) The Assistant Chief of the Accounts and Financial Reports Division
(2) The Assistant Chief of the Administrative Expenditures Division

(3) The Assistant Chief of the Financial Relations Division
(4) The Assistant Chiefs of the Operations Division for General Resources
(5) The Assistant Chief of the Operations Division for SDRs and Administered Accounts
(6) The Senior Accountant--Accounts and Financial Reports Division
(7) The Senior Operations Officers--Operations Division for General Resources
(8) The Senior Operations Officers--Operations Division for SDRs and Administered Accounts

2. Any one of the signatories mentioned above shall be and hereby is authorized to operate the Fund's No. 2 Accounts.

3. The foregoing officials, in conformity with this Decision, are hereby authorized and empowered in the name and on behalf of the Fund for its own account, or on behalf of the Trust Fund in accordance with Section III, Paragraph 1 of the Instrument annexed to Executive Board Decision No. 5069-(76/72), adopted May 5, 1976, or on behalf of the Supplementary Financing Facility Subsidy Account in accordance with Section II of the Instrument contained in Executive Board Decision No. 6683-(80/185) G/TR, adopted December 17, 1980, to open and operate cash, securities, and investment accounts with such banks and other institutions as have been or shall be designated as depositories of the Fund in accordance with Article XIII, Section 2, of the Articles of Agreement of the Fund, and with international financial institutions with which investments may be placed; to arrange for the deposit in such accounts of gold or currencies which shall be paid or payable to the Fund and any or all securities held by or to be delivered to the Fund; to execute and deliver any and all such drafts, endorsements, delivery orders, certificates, and other documents; to take any or all such other action as they shall deem necessary or proper in order to effect deposits in such accounts and withdrawals therefrom; and to issue such orders, demands, and instructions and to take all such other action as they shall deem necessary or proper in order to arrange for the safekeeping of such gold, currencies, and securities, the maintenance of such accounts, the withdrawal of any such gold, currencies, and securities therefrom, and the delivery of any such gold, currencies, or securities by any such depository or other institution.

4. This decision supersedes Executive Board Decision No. 7709-(84/82), adopted May 25, 1984. (EBAP/85/126, 5/13/85)

Decision No. 7982-(85/77), adopted
May 20, 1985

4. INTERNATIONAL COMPILERS' WORKING GROUP ON EXTERNAL DEBT STATISTICS - RELEASE OF INFORMATION

The Executive Board approves the proposal set forth in EBD/85/127 (5/16/85), to transmit the staff memorandum entitled "Statistics on International Banking and External Debt - A Progress Report" (SM/84/171, 7/17/84), to the participants in the second meeting of the International Compilers' Working Group on External Debt Statistics, to be held at Fund headquarters from June 12 to 14, 1985.

Adopted May 21, 1985

5. ADVISOR TO EXECUTIVE DIRECTOR - WAIVER OF ACCELERATED REPAYMENT OF SALARY ADVANCES

The Executive Board approves the proposal to waive the requirement for accelerated repayment of salary advances to a staff member appointed as an Advisor to an Executive Director, as set forth in EBAP/85/130 (5/16/85).

Adopted May 20, 1985

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/119 through 84/123 are approved. (EBD/85/125, 5/15/85)

Adopted May 21, 1985

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/131 (5/17/85) is approved.

8. STAFF TRAVEL

Travel by the Acting Managing Director as set forth in EBAP/85/132 (5/20/85) is approved.

APPROVED: March 4, 1986

LEO VAN HOUTVEN
Secretary