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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/126

10:00 a.m., August 26, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	Mawakani Samba
	M. K. Bush
	M. Lundsager, Temporary
	H. G. Schneider
B. de Maulde	X. Blandin
	M. B. Chatah, Temporary
	H. Kobayashi, Temporary
	B. Goos
J. E. Ismael	
R. K. Joyce	G. W. K. Pickering, Temporary
	J. R. N. Almeida, Temporary
	H. Fugmann
E. I. M. Mtei	A. Abdallah
	B. Jensen
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Chen J., Temporary

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

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<u>Also Present</u>
IBRD: J. F. Chevallier, Western Africa Regional Office, M. Devaux, Eastern and Southern Africa Regional Office. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; N. Abu-zobaa, M. Allen, A. Basu, M. W. Bell, E. L. Bornemann, E. A. Calamitsis, S. E. Cronquist, A. B. Diao, K. G. Dublin, C. Enweze, O. Kaba, S. N. Kimaro, R. H. Nord, R. T. Stillson, D. E. Syvrud, K. Thugge, R. A. Valdivieso, J. C. Williams. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; E. H. Brau, S. Kanesa-Thasan. Fiscal Affairs Department: R. J. Hurnard. IMF Institute: P. Angamessina, J. Raveloarison, Participants. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, J. K. Oh, S. A. Silard. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Berthet, J. C. Corr, M. F. Melhem. Advisors to Executive Directors: P. E. Archibong, L. K. Doe, D. Hammann, M. Z. M. Qureshi, N. Toé, K. Yao. Assistants to Executive Directors: W.-R. Bengs, A. K. Diaby, R. Fox, S. Geadah, V. Govindarajan, G. D. Hodgson, O. Isleifsson, Z. b. Ismail, J. M. Jones, E. Olsen, J. K. Orleans-Lindsay, J. E. Rodríguez, M. Sarenac, L. Tornetta, B. D. White

1. EXECUTIVE DIRECTOR

The Acting Chairman welcomed Mr. Mawakani as Alternate Executive Director to Mr. Alfidja and noted that Mr. Doe would resume the position of Advisor to Mr. Alfidja.

2. MADAGASCAR - REVIEW UNDER STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on the first review under the one-year stand-by arrangement with Madagascar approved in April 1985 (EBS/85/172, 7/22/85).

Mr. Alfidja said that Madagascar's economic and financial program was evolving satisfactorily: the policy measures envisaged under the program had been introduced, and all the performance criteria for end-April 1985 had been met. To provide appropriate incentives in general, and to encourage agricultural output in particular, the producer prices of several products had been increased in keeping with the program provisions, and the price of coffee had been raised by more than had been initially planned. In the rice subsector, further pricing and marketing liberalization measures had been introduced with a view to achieving self-sufficiency in rice in the medium term. In the fiscal sector, despite the recent indications of a possible revenue shortfall, the overall deficit would be kept within the program projections.

The debt rescheduling in May 1985 within the framework of the Paris Club should enable Madagascar to record a small increase in imports, especially of the raw materials and spare parts that were crucial for the growth of the economy, Mr. Alfidja noted. The authorities were continuing their policy of maintaining a flexible exchange rate based on the evolution of domestic prices.

Although the debt rescheduling had given the authorities some room for maneuver, the debt service burden remained heavy: it was projected to absorb about half of total export receipts in 1985, Mr. Alfidja remarked. The authorities agreed with the staff that their development effort would be greatly enhanced if the international commercial banking community were to show more effective support of Madagascar.

Mr. Ismael commented that the staff paper contained reassuring evidence of the authorities' commitment to implementing the program and of their ability to do so successfully. All the performance criteria for end-April 1985 had been met easily and all the agreed policy measures had been implemented. Developments during the first half of 1985 showed that the program remained firmly on track.

Satisfactory progress had been made in agricultural policy, exchange rate management, trade liberalization, and monetary and banking policy, Mr. Ismael considered. The measures taken in those areas seemed to be fully consistent with the program objectives.

Because of the weakening of the export performance in early 1985, the current account deficit for 1985 was likely to be larger than expected, Mr. Ismael continued. Moreover, given the poor markets for most commodities, particularly cloves, and the possible need for additional rice imports as a result of the drought and floods in 1985, the current account deficit could be even larger. Accordingly, the authorities' intention to maintain imports at a level lower than mentioned during the recent meetings of the Paris Club and Madagascar's Consultative Group was welcome. At the same time, the authorities were determined to minimize the constraining effects on growth of import restraint. They were to be commended for maintaining a flexible exchange rate policy, which would contribute significantly to export competitiveness, and for the steps they had taken to eliminate export taxes and to extend the coverage of the EPI (Exportations/pièces détachées-intrants) system, although he wondered why those measures had been limited to nontraditional exports. Similar incentive should be given to traditional export commodities such as cloves, vanilla, and sisal to offset the weakening of those markets.

Apparently the effect on revenues of the steps taken to promote exports would increase the difficulty of containing the fiscal deficit, Mr. Ismael observed. The Government's readiness to reduce certain expenditures to ensure that the overall treasury deficit would not exceed the amount envisaged under the program was welcome.

The authorities were to be commended for their performance under the program, Mr. Ismael considered, but given the severe constraints on the economy owing to the large external imbalance and sizable debt service burden, they could not afford to relax their efforts. The credibility of the adjustment program was crucial, as the economy would continue to depend heavily upon exceptional external assistance over the coming several years. There was little room for slippage if progress were to be made toward restoring growth and a viable balance of payments position, and the authorities should persevere in the implementation of the program. Finally, the proposed decisions were acceptable.

Mr. Abdallah noted that all the quantitative performance criteria had been met and the program objectives were likely to be achieved. The successful implementation of the program thus far showed that the adjustment momentum gathered under the previous program had not abated; all the policy measures agreed with the staff had been implemented. He hoped that, barring unforeseen adverse developments related to the weather, a stronger foundation could be built on which to restore stable financial conditions and to create an environment conducive to the resumption of rapid economic development.

GDP growth in 1985 was still expected to be higher than in 1984 but had been revised downward from 3 percent to 2.6 percent, Mr. Abdallah commented. There were serious statistical problems in Madagascar, but he wondered whether the staff had any further information on the factors that had caused that downward revision in the projected growth rate. It was not clear to him whether the revision was due to an inadequate flow of imported raw materials and spare parts or to other factors, such as adverse weather conditions. A slight increase in imports was expected in 1985--the first since 1980--and there was increasing evidence of the authorities' appreciation of the need to encourage imports of raw materials and spare parts to revitalize productive capacity and to support the growth objective.

The implementation of the fiscal element of the program was also progressing satisfactorily, although minor adjustments had had to be made, Mr. Abdallah remarked. He hoped that, once additional data were available, a clearer picture of fiscal developments could be drawn during the next review. Overall government revenue might be reduced by FMG 1.2 million owing to a projected export shortfall, and the authorities apparently were aware that in the absence of compensating revenue increases from other sources they would have to take appropriate action to ensure that the program would remain on track. In doing so the authorities should avoid reductions in capital expenditure, which could diminish the prospects for economic growth; Madagascar must generate export revenue to service its heavy external debt.

The main purpose of the present review was to assess the impact of the debt rescheduling agreements under the Paris Club, Mr. Abdallah commented. The forthright and generous behavior of Madagascar's creditors during the negotiations was encouraging, and he endorsed Mr. Alfidja's appeal for their continued support of the country's adjustment efforts. The comprehensiveness and strength of Madagascar's adjustment effort and the success achieved thus far in implementing the program should help to improve the country's creditworthiness, and the Fund could play an important role in helping Madagascar to be given favorable terms by its commercial creditors along the lines of the relief provided by the Paris Club creditors. Finally, the proposed decisions should be approved.

Mr. Suraisry said that he agreed with the main points in the staff appraisal and accepted the proposed decisions. The authorities were to be commended for introducing the agreed policy measures and for making progress under the stand-by arrangement. If the authorities were to continue their adjustment effort with the same determination they had shown thus far, adjustment in Madagascar was likely to be successful and the economy would probably be brought back onto a sustainable path. In that connection, he was pleased that the estimated growth in real GDP for 1985 was 2.6 percent, compared with 2.1 percent in 1984. That achievement underscored the importance of the policy prescriptions that had been designed to encourage domestic production; at the heart of that effort were the liberalization of agricultural marketing and the increases in producer prices. The authorities realized that such efforts should be continued.

Although the improvement in economic conditions could tempt the authorities to relax their adjustment effort, Mr. Suraisry remarked, they should strive to consolidate the gains achieved thus far. Further measures were needed to improve the balance of payments position--which would remain difficult for some time--and to correct the structural rigidities in the economy. The authorities had made a good start in that direction, and he particularly welcomed the measures they had taken to achieve a better distribution of expenditures over the financial year and to rehabilitate the banking system. Additional measures of those kinds were essential if rigidities were to be removed and restrictions eliminated.

The trade and payments system was complex and restrictive, and Madagascar had accumulated external payments arrears, Mr. Suraisry noted. Elimination of the exchange and trade restrictions and of the arrears as soon as possible was crucial for the success of adjustment in Madagascar.

The adjustment measures introduced by the authorities and the debt relief provided in support of those measures had enabled the authorities to make good progress in improving economic conditions in Madagascar, Mr. Suraisry concluded. The momentum of adjustment should be maintained to bring the economy onto a sustainable growth path.

Mr. Goos said that he agreed with the staff's analysis and recommendations and accepted the proposed decisions. The authorities were to be commended for having kept the stand-by arrangement on track. All the performance criteria for end-April 1985 had been met and all the agreed policy measures--including structural adjustment measures--were being implemented as planned. The structural adjustment policies apparently had already produced positive results in the agricultural sector--as reflected in that sector's unexpectedly good performance--and the staff had wisely encouraged the authorities to continue and reinforce their structural adjustment efforts.

While general economic developments seemed to be broadly in line with the original projections, he was somewhat worried by the revisions that had had to be made in the balance of payments targets, Mr. Goos continued. Those revisions had admittedly been made necessary partly by exogenous factors and partly by the desire to step up the imports needed to support overall economic growth. Nevertheless, the fact that the external current account deficit was expected to remain in excess of 10 percent of GDP in 1985 was unsettling. The authorities' intention to step up imports if exports performed better than projected was also a cause for concern. That matter was to be taken up with the authorities during the next review under the program, but at present great caution was called for in the import area given the continued precarious nature of Madagascar's balance of payments position and large debt service burden. The authorities should continue to aim for a significant reduction in the external imbalance. Achievement of their growth objective required an increase in imports of production inputs, but that should be achieved in the first instance through a further reallocation of foreign exchange in favor of such inputs within the overall import target. That approach seemed to be particularly appropriate in light of the increasing pressure on the trade account that was likely to occur as a result of the necessary import liberalization. In that context, the slow response of importers to the liberalized system of imports was disappointing; the system was to affect only some 2 percent of overall imports. He wondered whether the staff was satisfied with the authorities' explanation that the "relative newness of the system" was the main stumbling block in gaining a more positive response.

The unexpectedly rapid reduction in external arrears was welcome, Mr. Goos commented. Further progress in that area and in improving the external trade and current accounts should contribute greatly to overcoming the reluctance of foreign banks to provide new financing. It was equally important for the authorities to maintain their commitment to keeping the overall fiscal deficit within the original program target. That commitment had been reaffirmed by Mr. Alfidja in his opening statement, and it was evident that compliance with the relevant target could be greatly facilitated by forceful rehabilitation measures in the public enterprise sector.

The concise staff paper should serve as a model for further reviews in order to economize on the time of the staff and the Executive Board, Mr. Goos remarked.

Mr. Salehkhou said that Madagascar's economic and financial performance under the stand-by arrangement had been largely consistent with the program targets. All the performance criteria had been met with a generally large margin, and substantial progress had been made in implementing all the agreed policies. Moreover, although uncertainties about debt relief had not permitted a full assessment of the balance of payments outlook for 1985 at the time of the adoption of the stand-by arrangement, the favorable outcome of the meeting with official creditors seemed to indicate that the program's external targets remained adequate.

Although the program was clearly on track and no policy changes seemed necessary, the terms of the rescheduling of Madagascar's external debt to Paris Club members would not permit a much higher level of imports than that envisaged earlier in 1985, and the projection for real GDP growth in 1985 had been reduced from 3 percent to 2.6 percent, Mr. Salehkhou commented. Madagascar's significant progress toward achieving domestic and external adjustment under past stand-by arrangements had been accompanied by a substantial curtailment of imports that had been due only partly to the authorities' attempts to eliminate unproductive public investment and that seemed to have seriously affected the economy's productive capacity. The authorities had been expected to restore an appropriate volume of imports in 1985 to achieve sustainable real economic growth after years of negative or very low rates of increase in GDP. Imports in nominal SDR terms were projected to increase in 1985 for the first time since 1980 and should include significant increases in imports of raw materials and spare parts, but the increase over 1984 would be limited to 4.5 percent and would therefore contribute only marginally to the needed revival of the economy.

The low level of imports was a reflection of the continued weakness of Madagascar's balance of payments, which, despite the significant reduction in the current account deficit under successive arrangements, remained constrained by the sizable outstanding debt and the extent of structural imbalances that could be corrected only over the medium term, Mr. Salehkhou remarked. Moreover, in 1985 Madagascar's export performance was expected to be weaker than projected owing mainly to the impact of adverse weather conditions and of the appreciation of the U.S. dollar.

The authorities had maintained an adequate exchange rate policy and, despite continued payments difficulties, had introduced additional exchange and trade liberalization measures in line with their commitments under the stand-by arrangement, Mr. Salehkhou continued. The Government continued to maintain major restrictions, but he hoped that their elimination would be parallel with improvements in the overall balance of payments; under that approach, the authorities could cushion the adverse impact of the elimination of the restrictions on both the domestic economy and the external payments position.

Fiscal and monetary developments seemed to be largely in line with the program projections, including the original target of an overall government deficit of 4.7 percent of GDP, although the likelihood of a revenue shortfall had recently arisen because of the low level of exports, Mr. Salehkhou observed. The authorities had stated their intention to take appropriate steps later in 1985 to cover the revenue shortfall if it were not compensated by increases in other government revenues. In the light of the insufficient real GDP growth projected for 1985, the effort to offset the revenue shortfall should to the extent possible avoid new cuts in development expenditures.

The authorities were to be commended for their progress in implementing the stand-by arrangement, Mr. Salehkhou concluded. The proposed decisions were acceptable.

Mr. de Maulde noted that all the performance criteria had been met, some by a wide margin. In addition, all the numerous policy measures called for under the program had been implemented, Madagascar's official creditors had granted debt relief well in excess of the originally forecast amount, and the authorities were consistently introducing policies aimed at increasing production incentives and at liberalizing prices and marketing operations. Their latest initiative--a review of banks' portfolios--to promote the consolidation of the banking system was commendable.

However, the forecast of real GDP growth for 1985 had been revised from 3 percent to 2.6 percent despite the projected increase in imports of raw materials and spare parts needed for the development of nontraditional exports, Mr. de Maulde commented. Those imports seemed to have become the major bottleneck in the economic recovery; the authorities were implementing all the policies that the Fund and the World Bank had recommended. A further comment on the balance of adjustment and financing in Madagascar would be helpful. Finally, the proposed decisions should be approved.

Ms. Bush considered that Madagascar's performance to date under the stand-by arrangement had been satisfactory. All the end-April 1985 performance criteria had been met by wide margins, and agricultural production had continued to respond positively to pricing incentives; the recent abolition of the ceiling on the consumer price of rice was welcome. The Government apparently would be able to meet the performance criteria and achieve most of the program targets for the remainder of 1985. The authorities were committed to attaining the fiscal deficit target of 4.7 percent of GDP by cutting expenditures if the decline in revenues from exports were not compensated by increases in other revenues. She wondered whether there were any recent indications of additional revenue gains or expenditure cuts.

She had some reservations about certain aspects of the adjustment policies, Ms. Bush continued. Following the unexpectedly large amount of debt relief granted by the Paris Club, the authorities were planning to increase imports in order to encourage economic growth. However, the staff had noted that the GDP growth projection for 1985 had been revised downward. Economic growth was of course desirable, but she wondered whether the better than expected debt relief should not be used to some extent to bolster foreign exchange reserves.

The expected real depreciation of the Malagasy franc projected for 1985 had been reduced from 4.5 percent, as mentioned in the program, to just 3.5 percent, Ms. Bush added. Since the expected increase in export growth was slight, she wondered whether a faster rate of depreciation might not be appropriate. In the light of the authorities' wish to accelerate growth and to strengthen and diversify the export base, additional exchange rate adjustment seemed warranted. The projected external current account deficit for 1985 had been increased to 10.1 percent of GDP. Given the unfavorable medium-term outlook for the balance of payments and Madagascar's prolonged use of Fund resources, she had hoped that the projected current account deficit would be smaller--not larger--than originally programmed.

She shared the staff's concern about the role of commercial banks in the debt relief necessary to support Madagascar's adjustment effort, Ms. Bush said. The authorities should seek debt relief from non-Paris Club creditors similar to that provided by bilateral creditors.

Another area of concern was the degree of control over decision-making by producers, Ms. Bush remarked. The positive response of the agricultural sector to price adjustments suggested that stepped up liberalization of the industrial sector would help the authorities to achieve their economic growth objective. At the time of the adoption of the stand-by arrangement the authorities had indicated that they planned to take additional steps to give producers a larger decision-making role, and she hoped that progress in that area could be made by the time of the next review under the stand-by arrangement. She wondered whether the staff had any recent information on the so-called test program to rehabilitate the public enterprises that had been mentioned during the previous discussion on Madagascar (EBM/85/60, 4/23/85).

The authorities' commitment to implementing the adjustment program, as evidenced by their performance to date, was welcome, Ms. Bush concluded. Nevertheless, a strong effort would be required in the medium term if a sustainable payments position were to be attained. The pace of structural adjustment should be stepped up, and the authorities' reliance on World Bank advice and assistance should be increased. Finally, the proposed decisions were acceptable.

Mr. Sengupta said that the authorities' impressive adjustment efforts deserved the Fund's full support. The first paragraph on page 3 of the staff report contained an appropriate list of priorities for 1985, including an increase in the rate of economic growth and in gross domestic savings, stabilization of inflation, containment of the overall fiscal deficit, and a reduction of the current account and overall balance of payments deficits. The authorities had appropriately given first priority to raising the rate of economic growth; they had not made a reduction in the balance of payments deficit as a percentage of GDP the overriding policy objective; indeed, there had been a slight upward adjustment in the projection for that deficit in 1985. That forecast was not worrying, particularly if the projection for the rate of growth--even though recently revised slightly downward--were to prove correct.

Table 3, which summarized the principal policy measures in the 1985/86 program and the extent of their implementation, was particularly useful, as it showed the extent of the Fund's involvement in the country's policy effort, Mr. Sengupta commented. Indeed, the staff paper was a model for future reviews. In explaining the projected export shortfall for 1985 the staff noted on page 3 that, with respect to vanilla, "indications are that certain buyers have been delaying purchases called for under the three-year agreement signed in March 1984 as the U.S. dollar has appreciated in early 1985 relative to a number of principal currencies." A number of other developing countries had faced a similar problem with the behavior of buyers under medium-term and long-term contracts. He wondered whether the contracts involving Madagascar were not being honored by the buyers.

The staff noted that the authorities had assumed that SDR 5.5 million would be made available by commercial banks in 1985, Mr. Sengupta remarked. That assumption was based on the authorities' perception that their relations with banks had improved and on the support expressed during a meeting with bankers held in November 1984. In fact, the banks had remained reluctant to grant new financing to Madagascar, and he wondered whether management or staff could not hold informal discussions with the banks to encourage them to assist Madagascar.

Mr. Joyce considered that there were good reasons to be optimistic about Madagascar's progress under the stand-by arrangement: the performance criteria for end-April 1985 had been observed by a wide margin; the program targets were likely to be met; and the authorities had implemented an impressive list of policy measures. The summary of those measures in Table 3 was particularly useful and should serve as a model for similar papers.

Although the precise reasons for it were unclear, the deterioration in the balance of payments was a cause for concern, Mr. Joyce remarked. The deterioration was fairly small and the balance of payments deficit was still well within the program target, but the deficit remained large, and the fact that it had increased rather than fallen was regrettable. The Paris Club had provided only temporary debt relief, and some buildup of reserves or reduction in external arrears seemed desirable. The authorities clearly attached importance to increasing imports of essential items, including spare parts, but the recent increased import bill apparently was not due entirely to the effort to meet that objective. The authorities had maintained their longer-term effort to introduce a liberal system of imports, but it had not yet attracted many importers. He doubted whether the changes that had been made under the system were sufficiently ambitious.

Fiscal and monetary policy had been very supportive of the ongoing adjustment effort, Mr. Joyce observed. There had been some improvement in the performance of the public enterprises, but given the attention to that matter during the previous discussion on Madagascar, he was somewhat surprised that it had not received greater emphasis during the latest discussions with the authorities. The next review should provide a fuller, and possibly a more reassuring, indication of the authorities' progress in that area.

It was essential for the authorities to concentrate their adjustment efforts on supply-side, structural measures, Mr. Joyce said. Such measures were particularly important in a country that was a prolonged user of Fund resources and that was facing serious economic problems. The producer price changes initiated by the authorities over the previous several months were encouraging, and he hoped that the next review could include a detailed examination of the collaboration between the Fund and the World Bank in that area. The next review should also focus on needed improvements in the transportation and industrial sectors. The proposed decisions should be approved.

Mr. Suraisry said that he agreed with Mr. Sengupta that the Fund should informally encourage the commercial banks concerned to be more forthcoming in assisting Madagascar's adjustment effort.

The staff representative from the African Department commented that the originally projected growth rate for 1985 of 3 percent had been based on imports of approximately SDR 357 million, the figure used during the recent meeting of the Consultative Group for Madagascar. The authorities had felt that it would be prudent to reduce the level of imports below SDR 357 million because of the revised low level of exports. The reduced estimate of imports was one of the factors in the revised projection of economic growth; unfavorable weather conditions in early 1985 also had adversely affected agricultural output and economic growth. The weakened export performance was due to the effects of exogenous factors on vanilla and shrimp exports. There were recent indications of a possible further weakening because of the decline in coffee prices, and the staff would review the export performance during the 1985 Article IV consultation with Madagascar, which was scheduled to be held in the coming weeks. If the decline in exports exceeded recent expectations, imports would certainly have to be contained so that the balance of payments target could be met.

The commercial banks had given the authorities the impression that they might provide additional financing, but, so far, no such assistance had actually been received, the staff representative said. The original balance of payments projections had included approximately SDR 5 million in commercial bank financing; that amount had been excluded from the new balance of payments projections. The authorities had contacted the leading commercial banks with a view to requesting a renegotiation of the debt rescheduling agreed in October 1984, and meetings with commercial bank representatives were likely to be held during the 1985 Annual Meeting. Thus far the authorities had asked the staff merely to provide the banks with information about Madagascar's balance of payments and the outlook for the economy.

During the Executive Board's discussion of the stand-by arrangement for Madagascar (EBM/85/60, 4/23/85) the staff had indicated that the balance of payments deficit target would have to be increased in line with any rise in imports, the staff representative recalled. Ideally the authorities would have been able to increase the rate of growth and raise the level of exports, thereby enhancing Madagascar's debt service capacity. In fact, excess liquidity had been substantially reduced and indications were that a further reduction in the fiscal deficit and continued credit constraint together with other demand management measures would not result in a pronounced reduction in the external current account deficit. The external current account deficit excluding interest payments had fallen from some 12 percent of GDP in 1981 to approximately 4 percent in 1985; the main burden on the balance of payments was the heavy debt service.

In explaining why importers had reacted only marginally to the import liberalization measures, the authorities had noted that importers were not yet familar with the relevant new procedures, the staff representative remarked. It was also important to remember that only a few groups of commodities had been liberalized. The latest set of discussions with the authorities had taken place only shortly after the introduction of the system of import liberalization, and during the next review the staff would examine the latest experience with the system. The staff would certainly encourage the authorities to expand the system; and in the context of its sectoral and program loans, the World Bank would encourage the authorities to include in the liberalized import system imports needed for agriculture and industrial production. As to the system of EPI, which permitted exporters to retain a percentage of foreign exchange receipts to finance imports, it had not been extended to traditional exports because the prospects for those exports were unfavorable. Indonesia, the main market for clove exports from Madagascar, had been developing its own cloves, and prices of cloves had declined substantially in 1985. Coffee exports had been constrained by the country's quota in the International Coffee Organization. Vanilla exports were governed by a contract between buyers and producers, and as the price-setter Madagascar would not wish to weaken the market by flooding it with vanilla exports. Accordingly the authorities considered that in encouraging exports stress should be placed on nontraditional items.

The performance of the public enterprises remained a cause for concern for the Fund and World Bank staffs, the staff representative said. The test program in the public enterprise sector had covered only three enterprises, for which measures had been proposed to reduce their deficits and increase their profitability. Air Madagascar's performance had improved considerably; the sugar factories had made less progress because of the weakening of the sugar industry in general; and the power company had somewhat improved its performance.

In considering additional adjustment steps the authorities should stress the need for structural measures to accelerate economic growth, increase exports, and diversify production, the staff representative commented. Those measures should of course be supported by appropriate demand management policies. The next World Bank mission to Madagascar would take place in September--when the Fund staff planned its next visit--and the need for structural measures would be stressed.

Opportunities for revenue gains under the 1985/86 budget seemed to exist, the staff representative remarked. Indirect tax revenue estimates had been based on the assumption of an exchange rate of SDR 1 = FMG 650. In fact, the rate was likely to be SDR 1 = FMG 656-660. The authorities had prudently decided not to rely upon that possible source of revenue increase; they were still determined to achieve the fiscal targets by cutting expenditures if revenue gains did not materialize.

The question had been raised whether the unexpectedly large amount of debt relief should not be used either to reduce arrears or to increase reserves, the staff representative recalled. The staff and the authorities believed that an increase in imports that would be directed toward restructuring the economy and solving the structural problems would enhance Madagascar's debt service capacity and improve the external position. Further constraints on imports were unlikely to solve the balance of payments problems over the medium term.

The staff agreed with Ms. Bush that a faster rate of exchange rate depreciation was worth considering, the staff representative said. The authorities were committed to maintaining a flexible exchange rate throughout the program period. During the latest discussions with the authorities the staff had raised the possibility of a faster rate of depreciation to contribute to eliminating the structural problems facing the economy, and the matter would be raised again during the 1985 Article IV consultation discussions.

The authorities expected the contracts with the vanilla purchasers to be fully honored and the projected volume of exports for the year to be fully reached, the staff representative from the African Department commented; they had therefore reduced the export projections for vanilla with great reluctance. The staff would explore the situation with the authorities, in particular, the recent newspaper report that the Coca Cola Company, one of the major purchasers of Madagascar's vanilla exports, had recently decided to reduce its purchases.

The staff representative from the Exchange and Trade Relations Department remarked that the amount of financial assistance by commercial banks assumed under the stand-by arrangement had been modest because the staff had been aware that some time would be needed before confidence could be fully restored. In addition, the debt service burden created by commercial bank credit had had to be borne in mind. The commercial banks would probably seek the Fund's views in making their preparations for the coming discussions with the authorities. At that time, the staff would describe the progress that the authorities had made under the stand-by arrangement and would encourage the banks to decide, on the basis of their own criteria, to provide new financing to Madagascar. As a result of the previous discussions between the authorities and the banks there had been an expectation of a progressive resumption of some financing; the authorities continued to expect that resumption.

Ms. Bush said that a further comment on the relationship between the increase in imports and the downward revision in the GDP growth projection would be helpful.

The staff representative from the African Department explained that the original growth projection had been based on the assumption that imports in 1985 would reach SDR 357 million. During the discussions with the authorities on the stand-by arrangement the authorities had indicated that imports in 1985 were expected to be SDR 340 million if the terms of the debt relief provided in 1985 were the same as those provided in 1984. More generous terms would permit the level of imports to reach SDR 357 million. However, exports had subsequently declined, and to keep the current account deficit within reasonable limits the import program had been kept to SDR 344 million. The reduction in the import program from SDR 357 million to SDR 344 million, together with the effects of adverse weather conditions, were the main reasons for the downward revision in the GDP growth rate projection from 3.0 percent to 2.6 percent.

Mr. Alfidja said that his authorities hoped that the Fund would help them to reach an understanding with the commercial banks about further financial assistance to be provided to the country by the banks. The 1985 Article IV consultation would give the Malagasy authorities and the staff an opportunity to discuss recent unfavorable developments in the external sector. Despite those developments, the authorities believed that their balanced approach between adjustment and growth must be maintained.

The authorities also believed that it would be difficult to achieve the needed increase in exports, particularly by the industrial sector, if imports were further reduced, Mr. Alfidja commented. Moreover, according to the authorities, it would not be appropriate to reduce imports further in an effort to alleviate the deterioration in the external sector. To do so could have a serious negative impact on economic growth and exports. The debt service burden was still sustainable.

The Executive Board then took the following decisions:

Review Under Stand-By Arrangement

1. Madagascar has consulted with the Fund pursuant to paragraph 4(b) of the stand-by arrangement for Madagascar (EBS/85/82, Sup. 1) in order to establish performance criteria for end-December 1985 on total domestic credit and net credit to Government as contemplated in paragraph 16 of the letter dated February 15, 1985 from the Minister at the Presidency in Charge of Finance and Economy.

2. The letter dated July 2, 1985 from the Minister at the Presidency of the Republic of Madagascar in Charge of Finance and Economy shall be attached to the stand-by arrangement for Madagascar, and the letter dated February 15, 1985 attached thereto shall be read as modified and supplemented by the letter of July 2, 1985. Accordingly, the performance criteria on total domestic credit and net credit to the Government referred to in paragraph 4(a) of the stand-by arrangement shall be those specified in paragraph 4 of the letter dated July 2, 1985.

Decision No. 8052-(85/126), adopted
August 26, 1985

Exchange System

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

Decision No. 8053-(85/126), adopted
August 26, 1985

3. CAMEROON - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Cameroon together with a proposed decision concluding the 1985 Article XIV consultation (SM/85/201, 7/10/85, and Cor. 1, 8/23/85). They also had before them a staff report on recent economic developments in Cameroon (SM/85/221, 8/8/85).

The staff representative from the African Department said that the government budget for July 1985-June 1986 was balanced at CFAF 740 billion, compared with CFAF 620 billion in 1984/85. Budgetary revenue was estimated to increase by 19 percent over the budgeted level in 1984/85, mainly because of the continued expansion of the taxable base and partly because of modifications in taxation. The growth of current expenditure was to be limited to 7.5 percent, but capital outlays, which included the servicing of the external debt, were budgeted to rise by 41 percent.

Mr. Alfidja made the following statement:

The expansion of the Cameroonian economy continued in 1983/84. The external current account situation improved moderately, and the fiscal position was in near equilibrium. On the other hand, the inflationary pressures increased slightly, domestic credit expanded, and the foreign reserve position weakened.

Over the last several years developments in the real sector in Cameroon were quite impressive. From 1981/82 to 1983/84, overall economic activity expanded at an annual average rate of 6 percent. Following a slight slowdown in real GDP growth in 1982/83, the rapid pace of economic growth resumed in 1983/84 and is expected to accelerate in 1984/85. While the agricultural sector remains the cornerstone of the Cameroonian economy, the expansion of the oil sector has been much more rapid, thus providing the financial resources needed for the implementation of the current fifth development plan. The contribution of the oil sector to GDP rose from 8 percent in 1980/81 to 15 percent in 1984/85. The expansion in oil output offset the decline in price, thereby generating increasing petroleum export earnings over the years.

Reflecting the Government's commitment to develop the rural area, a significant portion of oil revenue is being utilized, in combination with a wide range of economic incentives, to spur growth in the agricultural sector. Steps taken to promote the development of this sector include direct assistance, which aims at revitalizing existing export crops such as coffee and cocoa and developing other crops. In addition, a flexible producer pricing policy is being implemented, taking into consideration, inter alia, movements in world market prices of the commodities and the rate of inflation in the rural area. Another major objective of the Government's agricultural policy has been the development of food-crop production, in part through a better supply of seeds. While these efforts have contributed to the expansion of agricultural output, my authorities are examining alternative approaches, including the promotion of financially more viable, larger farms, which would be more suited to new technology.

The expansion of activity in the industrial sector has been slowed by structural problems, including undercapitalization and pricing. Aware of the adverse long-term effects of these unfavorable developments, the authorities have taken some measures to address these problems; as a first step, they have converted tax liabilities into equity, assumed the external debt service obligations of some enterprises, and decentralized the pricing process. In the long run, in order to determine the future course of action to be followed regarding the ailing enterprises, the Government has requested the technical assistance of the World Bank. Furthermore, the authorities are encouraging the private sector to play a greater role in the promotion of small and medium-sized export-oriented enterprises based on the comparative advantages of Cameroon. In that regard, a new investment code was promulgated in mid-1984 to provide the necessary fiscal incentives, and FOGAPE, the small-business support agency, is being strengthened.

In the fiscal sector, budgetary revenue has exceeded current expenditure on average by about CFAF 100 billion since 1980/81. These large surpluses illustrate my authorities' determination to continue to pursue a cautious financial policy that not only takes into account the temporary nature of the oil revenue but also is flexible enough to allow prompt adjustments through a reduction of extrabudgetary expenditure whenever the prospect of a decline in revenue has to be dealt with. While revenue derived from oil production and exports has substantially contributed to the growth of total government revenue, steps have also been taken to reduce this dependence on oil. These include the strengthening of the tax administration, the increase in the domestic sales tax, and the introduction of a new specific tax on domestic gasoline consumption.

The monetary authorities of Cameroon are aware of the financial difficulties experienced by some banks as a result in part of some nonperforming loans. They are closely monitoring the financial performance of these banks and have taken steps to improve their profitability.

In the external sector, the improvement in the current account balance observed in 1983/84 is expected to continue in 1984/85 owing largely to the increase in oil exports. The current account surplus is forecast to increase from the equivalent of 1 percent of GDP in 1983/84 to 1.5 percent in 1984/85. While the external publicly guaranteed debt has increased slightly, it is still manageable by international standards.

Mr. Wijnholds said that he fully agreed with the staff appraisal, which commended the authorities for their economic performance but underscored the major structural problems facing the economy and the uncertainties about the medium-term outlook. The economic growth rate had been encouraging. Although the non-oil sector had grown less rapidly than the overall economy, its performance had essentially been satisfactory. The near self-sufficiency in food production was welcome and should be an example for other countries. In addition, inflation had been contained within reasonable limits, and the external position was strong.

The main task facing the authorities was to ensure that in the period ahead, when petroleum revenues were expected to decline substantially, structural problems would be tackled with sufficient vigor, Mr. Wijnholds continued. If those problems were permitted to persist or to become more serious, the authorities would have great difficulty in increasing or even maintaining the present comfortable level of per capita income.

Action was needed in a number of areas, Mr. Wijnholds considered. Government wage and hiring policies had placed a heavy burden on the budget: the wage bill had more than doubled over the previous five years, as government employment had risen by 9 percent a year on average. More cautious wage and hiring policies were required, particularly in view of the expected decline in petroleum revenues in coming years. In addition, the efforts to improve the financial performance of the public enterprises were insufficiently decisive. The request for World Bank assistance in designing the rehabilitation plans for key industries was most welcome.

The industrial sector faced considerable structural problems, including undercapitalization, overstaffing, managerial difficulties, and overprotection from imports through high tariffs and licensing, as well as rigidities in the pricing system, Mr. Wijnholds went on. Moreover, interest rate policy was insufficiently geared toward mobilizing domestic savings, as deposit rates were negative in real terms. The expected decline in oil resources also called for a greater effort to encourage domestic savings. It was his understanding that the authorities were well aware of the various problems he had mentioned; they must proceed with the required restructuring without delay.

The authorities' continued reluctance to provide the staff with full information on the oil sector was regrettable, Mr. Wijnholds said. The reasons they had given for failing to provide the information were no longer valid. The authorities should be more forthcoming in supplying such information in order to meet fully their obligations to the Fund, which should stand ready to provide the authorities with technical assistance. Finally, he accepted the proposed decision, which noted with satisfaction that Cameroon continued to maintain an exchange system that was free of restrictions.

Mr. de Maulde remarked that the staff report paid unusual, and welcome, attention to supply-side problems and development policies.

During the previous discussion on Cameroon (EBM/84/95, 6/18/84), concern had been expressed about the acceleration in the rate of inflation, Mr. de Maulde recalled. Since then, however, the rate had decelerated markedly. The staff had attributed that development to the improved supply situation and not to the authorities' policies, a conclusion that seemed somewhat unfair.

In the present paper on Cameroon, as in the previous one, the staff had noted with regret the authorities' reluctance to provide information about oil revenues, which apparently were partly deposited abroad and were not accounted for in the government budget, Mr. de Maulde commented. He agreed with the staff that the Fund was legally entitled to be provided with all the relevant financial data; indeed, there was need for technical assistance to accomplish that objective. However, in practical terms, the authorities were to be commended for having avoided persistent overspending by the Government. The staff had noted that the authorities felt that their approach had served Cameroon well during the period of rapidly rising resources, and that at present, given the prospect of a decline in revenues, adjustment could more easily be effected initially through cuts in extrabudgetary outlays. That approach was certainly appropriate.

The budget had recorded surpluses over a number of years, Mr. de Maulde went on. The staff had noted that, while expenditures had grown fairly rapidly during the previous several years, tax revenues had grown even faster, owing to the authorities' serious and cautious approach.

He wondered why the staff had concluded that deposit interest rates in real terms were negative, Mr. de Maulde said. After all, the rate of inflation was less than the rate on deposits, and the ratio of gross domestic savings to GDP in Cameroon was 34 percent, the same rate as that prevailing in Japan.

In analyzing the supply side of the economy, the staff had stated that oil exports were expected to decline from the current level of about SDR 1.5 billion to SDR 1 billion in 1990, while other exports were expected to grow by just SDR 100 million, Mr. de Maulde noted. Imports were projected to increase during the same period by SDR 600 million, and a trade deficit of SDR 300 million was forecast for 1990. Consequently, the authorities should consider adopting adjustment policies that would restrain the growth of imports of goods and services.

Demand management policies seemed appropriate and they would continue to play an important role in Cameroon in the coming period, Mr. de Maulde remarked. But the conclusions reached as part of the medium-term scenario should have been linked more directly to the authorities' supply-side policies. The effort to promote the production of exports and import substitutes was one way of ensuring against possible future trade deficits. At the same time, the report on recent economic developments contained detailed and useful coverage of the various productive sectors of the economy.

Cameroon's economy seemed to be on the right track, but the authorities appeared to be moving somewhat too slowly and in an excessively bureaucratic fashion, Mr. de Maulde said. For example, there had been no significant long-term growth in the production of agricultural export crops--cocoa, coffee, and cotton--even though the policies affecting prices and subsidies had been in the right direction. The authorities had acknowledged that they had undertaken a review of past policies and were studying possible additional measures, but he was worried that the reviews and studies might take a long time even if they were partially supported by the World Bank. In addition, plans had been drawn up, with World Bank assistance, to cope with the problems associated with rehabilitating ailing public enterprises. The problems had clearly been identified as undercapitalization, overstaffing, managerial deficiencies, overprotection from imported goods, and rigidities in the pricing system. Some of those problems seemed to call for immediate action; the authorities need not wait for the approval of a master plan to take the necessary steps. In that connection, IFC assistance might be helpful, and the lack of any indication of such assistance in Appendix II to SM/85/201, which covered Cameroon's relations with the World Bank Group, was surprising. While the authorities' management of the macroeconomic aspects of the economy was commendable, their traditional virtues of caution and deliberation were not serving the authorities as well in their handling of supply-side problems.

Cameroon's overall economic and financial performance continued to be among the best in Africa, Mr. de Maulde remarked. The authorities were to be commended for their achievements.

Ms. Lundsager commented that during the previous year Cameroon's economy had continued to be characterized by an enviable pattern of developments: real economic growth had been rapid, even in the non-oil sector; the rate of increase in consumer prices had fallen below 10 percent; the fiscal balance had returned to a surplus; the external current account and overall external payments position had improved markedly; and the external debt had increased only slightly. Exogenous factors, such as improved weather conditions, had played a role in that favorable outcome, but the authorities were to be commended for having taken the policy steps needed to generate the broad-based expansion of the economy. In particular, further development of the oil sector could have caused agricultural output to stagnate, as had happened in some other oil producing nations. In fact, over the previous several years the authorities had regularly raised producer prices and, as a result, Cameroon had attained near self-sufficiency in basic food production.

The attention given by the authorities to strengthening incentives and developing a broader economic base was commendable and should be maintained, and investment programming should stress the productive sectors, Ms. Lundsager considered. However, recent warning signs must be heeded if the authorities were to avoid growing external current account deficits and a rising external debt. Moderate retrenchment might be useful in the parastatal sector, particularly the industrial enterprises, many of which had suffered losses for a number of years, thus forcing the Government to step in to provide support, including the assumption of external debt-servicing obligations. Some steps had been taken to improve the overall situation--the closure of one enterprise, the sale of another enterprise to the private sector, and the introduction of some degree of price liberalization--but the burden created by the public enterprises remained large; extrabudgetary spending was occasionally required to maintain the viability of those enterprises. Since oil revenues were expected to decline or at best stagnate during the coming several years, the resources available to finance occasional bailouts of industrial enterprises would necessarily decline. The authorities should take a hard look at the public enterprises and draw up a priority list; those enterprises not on the list should be closed, or sold if interested buyers could be found. Furthermore, the extensive protection from competition given to those industries should be reduced, as broader competition from imports could quickly enhance efficiency. In the absence of such steps, the Government's support of the enterprises would become increasingly burdensome and resources would be consumed to protect enterprises that would not ultimately contribute to the development and growth of the economy.

Long-term gains could also be reaped from retrenchment in public sector employment, which had grown by about 7 percent a year in 1982-84, compared with 4 percent a year in the private sector, Ms. Lundsager commented. The overall unemployment rate apparently had been rising, and sustainable long-term growth of employment could be generated most productively by the private sector. An investment program that provided incentives and resources to the private sector could complement efforts to restrain the growth of the civil service. The encouragement the authorities were giving to small and medium-sized enterprises was welcome, as it should lead to an expansion of the productive base of the economy rather than to growth of the services sector.

The continued inadequacy of the data base complicated the formulation of economic policy, Ms. Lundsager remarked. The deficiencies in oil sector reporting could result in substantial oil revenue miscalculations that would affect assessments of budgetary revenues. The authorities had indicated that they would reduce extrabudgetary expenditures that were currently financed from oil proceeds held abroad, but that effort would probably be difficult, given the slow pace of reform of the public enterprises. Consolidation of all expenditures into one budget together with regular accounting of revenues would provide a more accurate picture of the fiscal health of the Central Government and the public enterprises. Finally, she agreed with the staff appraisal and accepted the proposed decision.

Mr. Abdallah stated that he broadly agreed with the staff appraisal and endorsed the staff's conclusion that Cameroon's economic performance was one of the best in Africa. The economy's impressive performance was a reflection of the authorities' efforts to avoid some of the pitfalls evident in the management of most oil producing developing countries. The authorities, aware of the problems involved in large and continuous monetization of oil revenue, had isolated a sizable proportion of that revenue from the banking system by holding it abroad and transferring it to Cameroon only to finance specific extrabudgetary projects. That policy enabled the authorities to provide for contingencies and spared the economy the problems of excess liquidity and inflationary pressures, thereby contributing to the internal and external financial stability that had enabled the economy to achieve rapid growth, particularly in 1980-85. The Board should show understanding of the authorities' wish to hold oil revenues abroad. If the total volume of those funds were to become well known, the authorities would have some difficulty in resisting pressures to bring the funds into the budget, a move that would have significant implications for absorptive capacity and the balance of payments.

He was pleased that the authorities were determined to keep agriculture the mainstay of the economy, particularly in the light of developments in crude oil production, Mr. Abdallah continued. The authorities' agricultural policies had resulted in the achievement of virtual self-sufficiency in food production despite intermittent drought-induced shortages. According to the staff, owing mainly to the fact that foodstuff prices had fallen by 2 percent in the first half of the year in response to the increased market supply, the inflation rate was likely to have dropped below 10 percent for 1984/85 as a whole. The authorities were to be commended for not having permitted the initial prospects for the oil sector to undermine their pursuit of agricultural objectives. However, their efforts must be aimed at substantially improving the export crop subsector, whose performance had been lacking despite increases in producer prices and large-scale subsidization of inputs. While it might be appropriate to further strengthen price incentives to stimulate cocoa and coffee production, much had to be done to modernize agricultural technology in Cameroon.

The authorities' prudent fiscal stance was encouraging, Mr. Abdallah commented. In recent years oil resources had grown rapidly and there had been substantial increases in government spending, but the spending had been kept within reasonable bounds and provision had been made for the achievement of overall fiscal surpluses and a sufficient accumulation of external reserves. Given the likely gradual decline in oil revenue and the difficulty in gaining access to international capital markets, the authorities' restrained budget expenditure policy was commendable. He agreed with the staff that to strengthen that policy the government wage bill, subsidies, and transfers should be reduced and efforts should be made to mobilize additional revenue from the non-oil sector. That effort might well entail modernization of the tax system and a strengthening of tax administration. The computerization of certain aspects of revenue collection and disbursement was in the right direction; it would, inter alia, minimize revenue losses.

The fundamental weakness of the industrial sector was a cause for considerable concern, Mr. Abdallah remarked. The industrial sector of Cameroon, like the industrial sector of other developing countries, was overprotected through high tariffs, quantitative restrictions, subsidies, and other types of government assistance. Appropriate measures to reform ailing enterprises were urgently needed, and Mr. Alfidja's statement that the authorities intended to work closely with the World Bank in formulating a rehabilitation program was welcome.

Cameroon was required to coordinate its monetary and credit policies with those of other members of the Central African monetary area, Mr. Abdallah noted. Nevertheless, the staff felt that a review of the level and structure of interest rates was called for. The authorities had taken the position that interest costs were deliberately kept low to encourage investment and enhance profit margins, and the staff had acknowledged that industrial production had recovered and had contributed to an "improvement in the financial position of several industrial enterprises, many of which are owned partly by the Government through its holding company." Given those developments and the likelihood that deposit interest rates were not negative in real terms, it was difficult to see why the staff favored higher interest rates. The staff should comment on the level of interest rates in Cameroon that would promote savings and investment within the coordinated policy of the Central African monetary area.

During the 1984 Article IV consultation discussions, attention had been drawn to the statistical shortcomings due, in the staff's view, to the method of compiling data in Cameroon, Mr. Abdallah commented. The shortcomings had persisted, and there was an urgent need to correct them if the data base were to be substantially improved, thereby enabling more reliable macroeconomic analysis and planning to take place. In that connection, Fund assistance might be helpful. Finally, the proposed decision was acceptable.

Mr. Wijnholds remarked that, if the authorities felt strongly that oil revenue data should not be published, the relevant data could be excluded from Fund publications. However, the authorities should provide the relevant information for inclusion in staff reports--which were confidential--thereby enabling the staff to provide a more reliable analysis. The published banking statistics already included data on the foreign assets of Cameroonian nonbank entities, as reflected in footnote 1 on page 6 of the staff report.

The staff representative from the African Department commented that, in the absence of certain important data, the staff had approached the analysis of Cameroon's economy with understanding and sensitivity. The staff agreed with Mr. de Maulde that the economy was on the right track. The authorities had performed well, never letting the economic and financial situation get out of hand, and the staff was fairly confident that needed changes in policies would be made. The authorities had indicated that they were prepared to reduce extrabudgetary outlays in response to a decline in oil revenues. However, the staff considered that, given the increased dependence of the government budget on oil revenues, the authorities might also have to make additional adjustments--for example, restraining the wage bill and subsidies and transfers--if oil resources should decline.

Although final data were not yet available, the rate of inflation apparently had fallen, the staff representative noted. Trends evident in July-December 1984 suggested that the inflation rate had probably dropped below 10 percent in the fiscal year ended June 1985. The staff had indicated that the improved supply situation had been the main factor--but not the only factor--behind the deceleration in the rate of inflation. It was difficult to draw definitive conclusions in the absence of complete data, and the staff had warned that some of its conclusions should be approached with caution. On page 65 of SM/85/221 the staff had presented estimates of the domestic fiscal balance, excluding the oil sector; since that balance had recorded a rising deficit in recent years, the staff had avoided attributing the easing of inflationary pressures to fiscal policy.

Deposit interest rates were negative in real terms, the staff representative said. The rate of inflation was currently about 10 percent, while the rate on all deposits up to CFAF 75 million was no more than 9.75 percent. However, lending rates were positive in real terms. Although Cameroon's interest rate policy had to be coordinated with that of the other members of the regional monetary area, the staff believed that there was a need for an overall review of the level and structure of interest rates with a view to both encouraging financial savings and ensuring an optimal allocation of resources.

Despite the data problems, the staff had presented a medium-term balance of payments scenario that highlighted the authorities' adjustment efforts and the need for further adjustment, the staff representative from the African Department concluded. The provision of more information by the authorities would increase their planning capability and would improve the prospects for holding more wide-ranging policy discussions during Article IV consultations. All the available indicators suggested that Cameroon's remarkable overall economic and financial performance was one of the best in Africa.

Mr. Alfidja remarked that Cameroon's attitude toward the provision of data on the oil sector was not unique. During consultation discussions with some members, there had been no indication that their approach toward the provision of oil data was inconsistent with their obligations under the Articles, and he hoped that there would be no such implications in the Fund's communications with Cameroon. The authorities had clearly made substantial progress and were committed to improving further the economic and financial situation. They had invited the staff to participate in discussions on the availability of balance of payments data and on balance of payments and debt management matters, and in its report the staff had recognized the progress that had been made in the provision of national accounts data. The authorities were effective economic and financial managers and clearly appreciated the usefulness of an adequate data base for their own purposes as managers and to meet their obligations to the Fund and the World Bank.

The Acting Chairman made the following summing up:

> Executive Directors noted with satisfaction that in recent years Cameroon had maintained an impressive rate of economic growth under conditions of broad internal and external financial stability. This commendable performance was attributed not only to the rapid expansion of crude oil production and exports but also to the determined efforts of the Cameroonian authorities to sustain the agricultural economy and to pursue generally prudent financial policies. Although a comprehensive assessment of financial developments was difficult, mainly because of the unavailability of complete information on the operations of the oil sector, indications were that in 1983/84 and 1984/85 the overall fiscal position had remained strong, the external current account had shifted into substantial surplus, and foreign borrowing had been kept within appropriate limits. However, it was also noted by Directors that Cameroon still faced major structural problems, the most serious being those of the large public enterprises in the industrial sector.
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> In light of the medium-term prospects of the oil sector, Directors were of the view that the authorities would be well advised to adapt their economic and financial policies to the likely decline in oil revenue, especially as there was still room for maneuver at this stage in the adjustment period. In

this regard, they welcomed the authorities' intention to reduce extrabudgetary outlays pari passu with any shrinkage in the resources accruing from the oil sector. However, given the increased dependence of the government budget itself on oil revenue, there would also be a need to restrain the growth of budgetary expenditure, particularly on recruitment and wages and salaries, as well as on subsidies and transfers. These measures of expenditure restraint would have to be coupled with intensified efforts to mobilize additional non-oil revenue. Moreover, a controlled fiscal stance would have to be supported by a prudent credit policy and an active interest rate policy designed to foster financial savings and improve the allocation of resources.

Directors stressed that the growth prospects of the economy over the medium term will depend importantly on the extent to which the remaining oil resources are allocated increasingly to directly productive investments. Cameroon's achievement of virtual self-sufficiency in food production was exemplary, but it was felt that greater efforts were needed to expand traditional agricultural exports through a combination of structural reform and a further strengthening of price incentives. More important, Directors felt that decisive action was urgently needed to come to grips with the serious structural and financial problems of the large public and mixed enterprises in the industrial sector. The resolution of these problems would require not only improvements in management but also appropriate pricing policies. In addition, the efforts to improve the performance of public and mixed enterprises would need to involve concerted actions to progressively expose these enterprises to more competition through a revision of the tariff structure and other protective measures. In this connection, Directors emphasized that Cameroon could greatly benefit from World Bank technical assistance; but, at the same time, Directors encouraged the authorities not to delay adjustments in areas where the need for changes was clearly evident.

In view of the prospective financial constraints, Directors indicated that it was important for the authorities to substantially improve Cameroon's economic data base in order to strengthen macroeconomic analysis and planning. While recognizing and having some sympathy for the reasons behind the authorities' treatment of the oil sector, Directors encouraged the authorities to adopt a more comprehensive and transparent approach to the management of the country's oil resources.

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

The Executive Board then took the following decision:

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

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

Decision No. 8054-(85/126), adopted
August 26, 1985

4. LIBERIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINTS UNDER RULE K-1 AND RULE S-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors considered a staff paper on the review of Decision No. 7987-(85/80) G/S/TR on complaints under Rule K-1 and Rule S-1 with respect to Liberia's overdue obligations to the General Department and SDR Department and the notice of Liberia's failure to settle Trust Fund obligations (EBS/85/199, 8/21/85).

The staff representative from the African Department commented that a staff mission had visited Liberia August 6-16, 1985. The authorities had presented a revised budget proposal to the Cabinet on August 16. The budget had been approved by the Cabinet and the Head of State on August 16 and had been announced publicly on August 19. Although the budget was moderately restrictive, it did not provide the resources necessary to cover the external debt service payments and to achieve the needed reduction in arrears.

Mr. Mtei commented that it had been clear for some time that the Government faced serious financial problems. During the previous discussion on Liberia (EBM/85/80, 5/24/85) the Governor of the National Bank of Liberia had gone to great lengths to explain the reasons for the economic problems facing the country and to assure the Executive Board that his Government remained committed to finding a solution to the problem of external arrears, particularly those to the Fund.

The Governor of the National Bank had emphasized that the failure to make payments to the Fund was not a deliberate action on the part of the Liberian Government but simply reflected the reality of the chronic lack of foreign exchange, Mr. Mtei went on. That point was even more relevant at present, given the substantial increase in arrears and the staff's apparent attempt to portray the case of Liberia as one similar to the case of Viet Nam. Although no payments had been made by Liberia since the Executive Board had adopted its decision on Liberia's overdue financial obligations on May 24, 1985, it was important to remember that the Liberian authorities had been willing to discuss their economic and financial problems with the Fund and had continued to show good faith in implementing adjustment policies suggested by the Fund while taking into account--as any government must--current social and political realities.

One of the main topics of discussion during the staff's recent mission had been the 1985/86 budget, Mr. Mtei remarked. Although the staff believed that the budget did not make sufficient resources available for external debt payments and the reduction of arrears, the authorities intended to reduce the fiscal deficit from the equivalent of almost 13 percent of GDP to about 6 percent--clearly a significant adjustment. To expect the Government to run a surplus in the current fiscal year--which was the only means by which adequate resources would be available to service domestic and external debt and to achieve a substantial reduction in arrears--would be to expect the impossible given the present social, political, and economic situation in Liberia. Indeed, it would be tantamount to calling for the Government to legislate itself out of existence. The Executive Board should continue to display understanding and flexibility toward Liberia. A tough decision on Liberia at the present stage would not help the country; indeed, it could only hurt it by undermining confidence in the economy.

Mr. Nimatallah inquired why the staff had suggested a further review period of three months rather than a shorter period.

The staff representative from the Treasurer's Department replied that the staff had given the matter considerable thought. At the relevant stage in the consideration of the case of Viet Nam, the Executive Board had fixed a period of six weeks for what had been in effect a contingent declaration of ineligibility. However, in two subsequent cases--Guyana and Nicaragua--which involved expectations of ineligibility, the Executive Board had provided for periods of three months. The staff had concluded that a similar approach would be appropriate in the case of Liberia, for which the nature of the decision was comparable. However, the precise period was of course for the Executive Board to determine.

Mr. Pickering said that the case of Liberia was particularly disappointing, as there were a number of obvious policy changes that the Government could make to improve the economic situation and, in particular, to strengthen its external payments position. The authorities had regrettably chosen not to make the needed changes. Indeed, overdue obligations to the Fund had existed since December 1984 and only one small payment had been made to the Fund over the previous nine months--and that payment had been made five months previously. In the circumstances, he agreed with the staff that the case of Liberia should be handled somewhat more forcefully than some recent cases of overdue financial obligations to the Fund. It seemed reasonable to use the firm approach represented by the second version of draft paragraph 4 of the proposed decision, which was similar to the approach used in the case of Viet Nam. However, in the light of

Mr. Alfidja remarked that it was his understanding that the only available courses of action by the Fund were the two alternative versions of draft paragraph 4. In the light of Mr. Mtei's opening comments, he was willing to accept the first, more flexible alternative in order to give the authorities sufficient time to handle the problem of their arrears to the Fund.

The staff representative from the Legal Department explained that the alternatives in the draft decision had been proposed in the light of the relevant previous Executive Board decisions and were in keeping with the principle of uniform treatment of members. While the alternatives in the present paper seemed the most appropriate ones in the eyes of the staff, the Executive Board could of course choose other options if it wished to do so.

Mr. Goos remarked that Liberia was apparently one of the most intractable cases of overdue payments to the Fund with which the Executive Board had had to deal thus far. That Liberia had made no payments to the Fund in recent months was regrettable, particularly in view of the assurances that the authorities had given during the previous discussion on Liberia, when it had been said that the Government attached the highest priority to settling the overdue obligations. Nevertheless, as indicated in the staff paper, there were some differences between the cases of Liberia and Viet Nam, suggesting that the Liberian authorities were not indifferent to their external payments arrears. The revised budget proposal for 1985/86 and Liberia's request to the Fund for technical assistance were positive developments that should be taken into account in considering the proposed decision, although he agreed with the staff that the measures fell considerably short of those required, especially to provide sufficient resources to eliminate external arrears. He was inclined to conclude that the appropriate action at the present stage was to adopt a decision expressing merely the expectation that Liberia would be declared ineligible to use the Fund's resources at the next review in the absence of full settlement by then of Liberia's arrears to the Fund.

Mr. Clark stated that he favored the approach mentioned in paragraph 5(c) on page 3 of the staff paper and reflected in the first version of paragraph 4 of the proposed decision. That approach was appropriate since in some respects the case of Liberia differed from that of Viet Nam. While Liberia's situation was certainly difficult, the authorities' failure to act more firmly and promptly to address the economy's problems was disappointing; the staff had concluded that the measures the authorities had adopted thus far were inadequate.

Mr. Nimatallah said that he agreed with the staff that the case of Liberia was similar to that of Viet Nam: the Liberian authorities had shown no indication that they would repay the Fund and had failed to implement any adjustment measures that would correct the serious imbalances in the economy. Hence, he preferred the approach mentioned in paragraph 5(d) on page 3 of the staff paper, under which the second version of paragraph 4 of the draft decision would be approved. In addition, the date of the next review in paragraph 4 should be October 25, 1985, rather than November 25, 1985. The authorities apparently had a recalcitrant attitude toward the Fund: there was no evidence that they had in mind a specific program of action to settle their arrears to the Fund. Accordingly, unless Liberia were to become current in its financial obligations to the Fund it should automatically become ineligible to use the resources of the Fund beginning October 25, 1985. However, in the light of Mr. Mtei's opening comments, he could go along with a majority view in favor of the first version of paragraph 4 of the draft decision. If that version were adopted, Mr. Mtei should impress upon the Liberian authorities the urgency to act to settle promptly Liberia's overdue obligations to the Fund. It was unfortunate that some member countries that clearly needed substantial Fund support of their adjustment efforts had treated the Fund in an indifferent manner. The authorities of those countries should give the highest priority to cooperating with the Fund.

Mr. Chatah said that he was disappointed that since the previous discussion on Liberia there had been little if any movement by the Liberian authorities to deal with the serious and deteriorating situation concerning the country's overdue obligations to the Fund. Equally disappointing was the fact that, despite the gravity of the economic and financial situation, the authorities apparently were neither ready nor willing to adopt the substantive and comprehensive policies needed to bring the economy back on a viable track. Mr. Mtei had noted the recent adoption of the 1985/86 budget, but the staff had said that the budget did not seem to provide adequate resources to cover external debt payments and to reduce arrears. That conclusion raised doubts about the priority the authorities were giving to arrears, particularly those to the Fund. Given the existing monetary arrangements in Liberia, the settlement of external obligations was basically a budgetary issue; the increase in extrabudgetary expenditures alone in 1984/85 had greatly exceeded Liberia's overdue obligations to the Fund.

He wondered whether the present exchange system was being reviewed by the authorities, Mr. Chatah remarked. The system had been one of the main topics of discussion during the 1985 Article IV consultation with Liberia (EBM/85/112, 7/24/85). Finally, in the light of the comparisons made in the staff documents between Liberia and previous cases of overdue obligations and of the comments made by various previous speakers, he could go along with the first version of paragraph 4 of the proposed decision.

Mr. Rye said that he too considered the case of Liberia a particularly serious one. The Government had made no effort to fulfill its earlier undertakings regarding repayment to the Fund, and it clearly was not implementing the major adjustment measures required to tackle the substantial debt problems and to eliminate the overdue obligations to the Fund. The overdue and projected future obligations to the Fund--covering the coming seven years--totaled some SDR 317 million, almost 80 percent of which would fall due by 1988. Nevertheless, he did not favor the second version of paragraph 4 of the draft decision. It would not be useful to tie the Executive Board's hands by establishing forthwith a date on which Liberia would be declared ineligible to use the general resources of the Fund. The first version of paragraph 4 should be approved.

Mr. Zecchini stated that he was disappointed and concerned by developments regarding Liberia's overdue obligations to the Fund. During the previous discussion on Liberia (EBM/85/80, 5/24/85), the Executive Directors had been given assurances by the authorities that they intended to create a special account to service priority foreign debts, but no payment had actually been made to the Fund. He hoped that that development was not a sign that the authorities had given a low priority to meeting their financial obligations to the Fund. There was no concrete evidence that Liberia was taking any strong, effective action to cope with either the arrears or the deteriorating economic and financial situation; that was particularly worrying because large financial obligations would fall due in coming years. In the absence of a major adjustment program, Liberia's overdue payments to the Fund might increase sharply in the medium term.

He agreed with the staff that Liberia's case was more similar to that of Viet Nam than to the cases of Nicaragua and Guyana and that the decision on Liberia should be worded to reflect the evenhanded treatment of members with overdue obligations to the Fund, Mr. Zecchini said. The decision should therefore include a statement of expectation by the Executive Board that at the time of the next review Liberia would be declared ineligible to use the Fund's general resources unless Liberia had become current with the Fund by that date. However, it might be best not to have the Executive Board bind itself to such a course of action and to take a more flexible position, stating that at the time of the next review the Executive Board would consider further steps, including the possibility of declaring Liberia ineligible to use the Fund's general resources. That possibility should be made clear forthwith to the Liberian authorities.

Ms. Bush recalled that during the two previous discussions on Liberia she had noted that the extent of the authorities' commitment to deal with the growing problem of their overdue obligations to the Fund was a cause for serious concern. During the discussion in May 1985, the Governor of the National Bank of Liberia had made several positive statements about the Government's intentions, particularly the plan to open an account expressly for depositing offshore receipts to be used for priority debt service payments. Since then, however, no payments had been made to the Fund, although some payments had been made to the World Bank and to the Paris Club account. She wondered how the authorities could expect to convince the Executive Board of the seriousness of their intentions when they failed to make any payments to the Fund.

A staff mission had visited Liberia in early August to advise the authorities on the formulation of macroeconomic adjustment policies and to discuss a possible approach to the problem of payments arrears, Ms. Bush commented. The staff had concluded that the revised budget proposal did not provide adequate resources to reduce arrears and to continue to service the debt. Moreover, during the most recent mission to Liberia the authorities had made no firm indications regarding payments to the Fund.

A case could be made for adopting either of the options proposed by the staff in the present paper, Ms. Bush considered. The lack of payments to the Fund and of any clear indication that the authorities intended to deal with the problem of arrears to the Fund was a cause for great concern. Nevertheless, there seemed to be a small sign of hope that that problem would eventually be solved. Although it was clearly inadequate, the revised budget reflected some concern by the authorities about the economic situation in Liberia. Given that small measure of progress, and in the light of comments made by previous speakers, she was willing to support the first version of paragraph 4 of the proposed decision, under which the Executive Board would expect to declare Liberia ineligible to use the Fund's resources on November 25, 1985 in the absence of full settlement by then of Liberia's financial obligations to the Fund. However, the authorities must take several steps forthwith: the financial problems must be tackled in a more forceful manner, including steps to restore Liberia's credibility with the Fund by immediately reducing its overdue obligations; and revenue measures and expenditure controls must be introduced forcefully to help to bring the economy back on a viable path.

Mr. Wijnholds said that the authorities' lack of progress in settling their overdue obligations to the Fund was disappointing. The case of Liberia was similar to that of Viet Nam, but there was a small basis for distinguishing between them, and he was therefore willing to go along with the first version of paragraph 4 of the proposed decision.

The staff representative from the African Department remarked that during its latest visit to Liberia the staff had presented the authorities with a copy of the Chairman's summing up of the Executive Board's discussion of the staff report for the 1985 Article IV consultation (EBM/85/112). The staff had emphasized the need to adopt appropriate fiscal measures, to reduce external arrears, and—during a closed session with the Minister of Finance and the Governor of the National Bank--to review the monetary system. Moreover, the staff had helped the authorities to prepare the revised budget, under which the overall deficit would be reduced from about 13 percent of GDP to 3 percent. However, the staff had concluded that, given the huge accumulation of arrears, even a reduction of the deficit to 3 percent of GDP would be inadequate. The staff had noted that there was a de facto dual currency system and that an additional issue of $2.4 million in coins had occurred during its visit. The staff had stressed that, having exhausted their external credit, the additional issue of $2.4 million in coins had occurred during its visit. The staff had stressed that, having exhausted their external credit, the authorities would inevitably see Liberia's economic and financial condition continue to deteriorate in the absence of a serious adjustment effort.

Mr. Mtei commented that the authorities clearly were not indifferent to the need to eliminate their overdue obligations to the Fund. They simply were unable to make the payments: they did not have the required foreign exchange. The authorities had significantly reduced the budget deficit and, given its present exchange and currency arrangements, Liberia could not make substantial payments to the Fund without running a fiscal surplus. He hoped that the Executive Board would be flexible in its approach to Liberia, whose situation was extremely difficult.

The Executive Board then took the following decision:

1. The Fund has reviewed Decision No. 7987-(85/80) G/S/TR, adopted May 24, 1985, in light of the facts described in EBS/85/199 (8/21/85) pertaining to Liberia's overdue financial obligations to the Fund.

2. The Fund regrets the continuing nonobservance by Liberia of its financial obligations to the Fund and notes that further substantial obligations will fall due in the near future. The Fund urges the Liberian authorities to make full and prompt settlement of the overdue financial obligations to the Fund.

3. The Fund calls upon Liberia to adopt urgently a strong and comprehensive program that would result in necessary economic adjustment.

4. The Fund shall review further Decision No. 7987-(85/80) G/S/TR, on November 25, 1985, taking into account any further developments. It is expected that a decision to declare Liberia ineligible to use the Fund's general resources, pursuant to Article XXVI, Section 2, will be taken, with effect on that date, in the absence of full settlement of Liberia's financial obligations to the Fund in the General Department by that date. It is further expected that a decision to suspend, pursuant to Article XXIII, Section 2(b), Liberia's right to use SDRs it acquires after November 25, 1985 will be taken, with effect on that date, in the absence of full settlement of Liberia's financial obligations to the Fund in the SDR Department by that date.

Decision No. 8055-(85/126) G/S/TR, adopted
August 26, 1985

5. TANZANIA - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINTS UNDER RULE K-1 AND RULE S-1, AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors considered a staff paper containing a proposed decision regarding the Managing Director's complaints under Rule K-1 and Rule S-1 with respect to Tanzania's overdue obligations to the General Department and the SDR Department together with the notice of Tanzania's failure to settle its Trust Fund obligations (EBS/85/198, 8/21/85).

Mr. Mtei said that his Tanzanian authorities regretted the delay in settling their overdue obligations to the Fund. In keeping with the importance that they attached to the matter, he had recently been invited to Tanzania for extensive discussions, during which the arrears to the Fund had been one of the major topics, and the Minister of Finance had reaffirmed Tanzania's commitment to eliminating the arrears as soon as possible; he had stressed that the delay was not the result of a deliberate decision by the authorities but instead reflected the serious problems that still faced the economy. The authorities had also stressed that Tanzania's foreign exchange position had worsened in recent months--owing to seasonality factors--and remained precarious. Moreover, as a result of the continued erosion of Tanzania's creditworthiness in the eyes of Tanzania's suppliers, the country had to pay cash for essential imports. That requirement had been introduced at a time when Tanzania's export receipts had reached the lowest point of the annual cyclical pattern. The authorities expected export receipts to pick up in the coming several months, thereby giving them an opportunity to settle their overdue obligations to the Fund.

His authorities had stressed the importance they attached to their relations with the Fund, Mr. Mtei said. They understood that settling their overdue obligations to the Fund was the only way in which they could restore external confidence and facilitate the resumption of normal trade and payments practices. Accordingly, they had given the highest priority to eliminating their overdue obligations to the Fund, and they hoped that the Fund would give them more time in which to do so, particularly in view of the cyclical nature of Tanzania's export receipts.

Mr. Nimatallah inquired whether the essence of Mr. Mtei's opening comments had previously been communicated direct to management or staff.

The Deputy Director of the African Department replied that the staff had not received such a communication from the Tanzanian authorities. However, in their discussions with the staff the authorities had consistently indicated their interest in trying to settle the overdue obligations as soon as possible.

Mr. Nimatallah said that he wondered why the authorities had waited in effect until the last moment to give the Fund an explanation of the difficulties facing them. Apparently the authorities assumed that the

Executive Board would approve a further review period and that they could continue to give a low priority to eliminating their overdue obligations to the Fund. At the least, the authorities should have formally indicated to the Fund their intention of taking appropriate action to settle their overdue obligations. In the absence of that communication it seemed appropriate for the Executive Board to take a fairly stringent position on those obligations. What seemed to be the present practice of automatically providing three-month review periods should be reviewed. Each case of overdue obligations should be considered on its own merits. In the case of Tanzania, a review period of less than three months might well be warranted.

Mr. Wijnholds commented that the lack of progress in settling Tanzania's overdue obligations to the Fund was disappointing. The fact that the amounts involved were not large made Tanzania's failure to pay them particularly worrying, especially as the authorities had previously indicated that they intended to take appropriate action fairly soon. The case of Tanzania was clearly a cause for concern.

Mr. Chatah noted that EBS/85/198 seemed to contain less information and substantive analysis than was typical of staff papers brought to the agenda of the Executive Board. He wondered whether the staff had had any difficulty in obtaining sufficient information from the authorities.

The staff representative from the Treasurer's Department recalled that the main discussion by the staff of Tanzania's overdue financial obligations to the Fund had appeared in EBS/85/155 (6/19/85) and Supplement 2 (7/19/85). Accordingly, EBS/85/198 was in effect merely a further supplement that described recent developments. The earlier papers also contained the staff's communications with the authorities on the subject of Tanzania's overdue financial obligations to the Fund.

The Deputy Director of the African Department said that there had been no recent discussions between the staff and the authorities on their economic policies. The staff had hoped that, following the staff mission in March 1985 when the possible use of Fund resources by Tanzania had been considered, the authorities would be somewhat more forthcoming and would hold substantive discussions on their policies. In that connection, the staff had also hoped to hold the 1985 Article IV consultation discussions before the 1985 Annual Meeting. However, because of the pending elections those consultations had been postponed until sometime after November 1985. The only recent information that the staff had received about the authorities' policies was the announcement of the new budget in mid-1985. The Permanent Secretary had visited Washington in 1984 after the announcement of the budget to indicate to the staff the broad areas in which the authorities intended to implement corrective measures; in contrast, the recently announced budget did not indicate a corrective course for future policies. In the absence of any direct discussions with the authorities the staff had not felt that it was in a position to provide in the present paper any substantive analysis of the authorities' economic and financial policies.

Mr. Alfidja remarked that it was regrettable that Tanzania had been unable to settle some of its overdue financial obligations. However, the Executive Board should treat the case of Tanzania in the same way that it had treated other similar cases. Accordingly, the decision adopted at the present meeting should be reviewed within three months. There should not be automatic agreement to have a review period for Tanzania or any other country with arrears; each case should be considered on its own merits. However, the treatment of all cases should be uniform. The Fund's practice with respect to cases of overdue obligations should perhaps be reviewed, but in the meantime the Board should agree on a three-month review period for Tanzania.

Mr. Nimatallah considered that the Fund had not established formal procedures for dealing with cases of overdue financial obligations. The Executive Board had in fact acted on an ad hoc basis and had consistently taken into account the actions taken by the authorities to improve their economic situation. The Tanzanian authorities had failed to give the Fund any indication that they intended to take needed corrective actions, and it seemed unfair to other members with overdue financial obligations for the Executive Board to agree automatically to a further three-month review period for Tanzania. Accepting a further period of three months for Tanzania would in effect violate the principle of uniform treatment of members.

The staff representative from the Legal Department said that 30 days previously the Tanzanian authorities had been informed that a complaint against Tanzania was to be considered by the Executive Board on August 26, 1985. In addition, they had been invited to present their views to the Executive Board through a specially appointed representative, who could be the Executive Director for Tanzania or some other person designated for that purpose. The authorities had chosen to designate the Executive Director to present their views during the present discussion. The authorities had been under no obligation to present their views to management before the present discussion. The proposed decision was not meant to countenance any delay or inaction on the part of the Tanzanian authorities. Rather, the decision provided for severe action on the part of the Fund, namely, to limit Tanzania's right to use the resources of the Fund. The Fund had at its disposal a scale of actions of increasing severity that it could take in handling cases of overdue financial obligations, and the action provided for in the proposed decision was the initial action that had been taken in previous cases in which a member had failed to meet its financial obligations to the Fund.

Mr. Clark stated that he accepted the proposed decision. However, he sympathized with Mr. Nimatallah, who wished to avoid automatically granting a kind of grace period to each member with overdue financial obligations to the Fund. The Tanzanian authorities should press ahead, in collaboration with the Fund, to formulate and implement a comprehensive adjustment program. They had implemented some substantive measures under the previous budget, and their reluctance to take additional steps under the new budget to achieve sustainable improvement in the economy was disappointing.

Mr. Pickering said that it was discouraging to note the poor prospects for repayment to the Fund by Tanzania over the coming several months. Moreover, it was regrettable that Tanzania had made no payments to the Fund over the previous several months despite the indications by the authorities that payments would be made. The proposed decision was acceptable, but he, like Mr. Nimatallah and Mr. Clark, viewed the problem of overdue obligations with growing concern. There had been no case history of overdue obligations at the time of the previous general review of overdue obligations, and he looked forward to conducting a general review of the relevant policies in the near future. He asked the staff to explain what guidelines were available to the Executive Board after a complaint was presented to the Board.

The staff representative from the Treasurer's Department responded that there were guidelines for consideration of a case of overdue obligations after a complaint had first been considered substantively, in the sense that the Executive Board had decided that it would return to such cases in order to review its initial decisions on them. The period for those reviews normally should not exceed three months. It would be fully consistent with those guidelines for the Executive Board to set a much shorter review period than three months in the light of the circumstances of a particular case. The general question of the review period seemed to warrant examination by the Executive Board, since there had been some feeling that the review period might be interpreted as acquiescence by the Executive Board in further delays in payment, something that the Executive Board certainly had not intended. In setting a review period the Executive Board was refraining from taking other action in order to give the member country concerned some time to become current with the Fund. A general examination of the review period and other related matters could be undertaken at the time of the Executive Board's consideration of the next six-monthly report on overdue obligations, which was expected to be issued in September 1985.

Mr. Nimatallah stated that the one-month period prior to the notification to the Executive Board of the Managing Director's complaint should not be seen by the authorities as time given to them merely to explain why they had not yet repaid the Fund. Instead, the authorities should consider immediately ways of eliminating their overdue financial obligations to the Fund.

Mr. Salehkhou said that he fully sympathized with Mr. Mtei. The difficult situation in Tanzania was due to factors beyond the authorities' control. During a discussion he had recently held with the Governor of the Bank of Tanzania the Governor had stated that the Government gave the highest priority to eliminating its overdue financial obligations to the Fund and hoped that the export proceeds needed to repay them would be available by the end of the summer of 1985. Unfortunately the proceeds had not become available. He was convinced that the authorities had made every effort to eliminate Tanzania's overdue obligations and that the Executive Board's approach to Tanzania should be flexible.

Ms. Bush commented that she believed that the authorities should press ahead in formulating and implementing an adjustment program; the lack of progress thus far had caused her to doubt whether the authorities recognized the urgent need to implement corrective measures and to repay the Fund. The fact that in recent months Tanzania had made no payments to the Fund and had not been in direct contact with staff and management was a cause for concern. An earlier paper (EBS/85/155, 6/19/85) contained a communication from the Governor of the Bank of Tanzania to the Managing Director in which it was stated that the overdue obligations would be settled by the end of August 1985. In fact, the authorities had made no progress in reducing the obligations. It was true that the Tanzanian authorities were not legally obligated to have communicated direct with staff and management prior to the present discussion, and Mr. Mtei's opening comments--which had benefited from his consultations with the authorities--had certainly been helpful. However, the authorities had had a kind of moral obligation to communicate direct with the Fund prior to the present discussion.

Tanzania's overdue financial obligations to the Fund were equivalent to 2.4 percent of the country's current account receipts, Ms. Bush remarked. Tanzania obviously faced serious economic and financial problems, but the volume of overdue obligations was fairly small, and immediate repayment to the Fund could keep the payment of the overdue obligations from becoming unmanageable. Finally, the proposed decision was acceptable; it should be reviewed within three months, although review periods of three months should not be granted automatically, and an examination of the practice with respect to review periods was warranted.

Mr. Goos said that Tanzania's failure to make any payments to the Fund since the previous discussion on its overdue obligations was a cause for concern. He agreed with Ms. Bush that the authorities should have communicated direct with staff and management prior to the present discussion; thus far, the staff and the authorities had been unable to reach agreement on a comprehensive adjustment program. He sympathized with Mr. Nimatallah; the issue of the review period should be examined during the coming review of overdue financial obligations to the Fund. The proposed decision in EBS/85/198 seemed consistent with relevant previous decisions and should be approved.

Mr. Mtei considered that the Tanzanian authorities had fully met their obligations to the Fund by consulting with him in recent months and designating him to present their case to the Executive Board at the present meeting. In addition, the authorities had introduced a variety of policy measures to improve the economic and financial situation. The measures had been announced in the new budget, but, because of the pending elections, the authorities had not been in a position to hold Article IV consultation discussions in recent months. The elections would result in a new administration and possibly some redirection of policies. Consultation discussions probably could take place after a new government was formed.

The Executive Board then took the following decision:

1. The Managing Director has reported under Rule K-1 and Rule S-1 of the Fund's Rules and Regulations to the Executive Board the facts on the basis of which it appeared to him at the dates of these reports that Tanzania was not fulfilling its obligations under the Articles of Agreement and submitted complaints and a notice on June 19, 1985 (EBS/85/155) in accordance with those Rules. The complaint under Rule K-1, as amended on July 19, 1985, was that as of July 17, 1985 Tanzania was not fulfilling its obligations relating to repurchases and the payment of charges in the General Department in the total amount of SDR 8,794,004. The complaint under Rule S-1, as amended, was that as of July 17, 1985 Tanzania was not fulfilling its obligations to pay charges and an assessment in the SDR Department in the total amount of SDR 651,781. Furthermore, the Managing Director added to his complaints a notice of the facts on the basis of which it appeared to him that as of July 17, 1985, Tanzania was not fulfilling its obligations under Decision No. 5069-(76/72) with regard to the Trust Fund to repay disbursements and pay interest in the total amount of SDR 362,031. These facts, and the complaints and notice of the Managing Director, were communicated to the authorities of Tanzania on July 19, 1985.

2. Taking into account the further obligations of Tanzania that have become overdue since July 17, 1985, Tanzania's overdue obligations to the Fund have increased to SDR 8,950,279 in the General Department, to SDR 1,271,528 in the SDR Department, and to SDR 3,455,223 under the Trust Fund.

3. Having considered the reports of the Managing Director, the complaints and the notice, and the views of Tanzania, the Fund finds that Tanzania has failed to fulfill its obligations under the Articles of Agreement and the Trust Fund as stated in paragraphs 1 and 2 above.

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

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

(b) pursuant to Article XXIII, Section 2(b) of the Articles of Agreement to suspend the right of Tanzania to use SDRs it acquires after the suspension until such time as Tanzania has become current in its obligations to which that provision applies, and

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

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

Decision No. 8056-(85/126) G/S/TR, adopted
August 26, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/125 (8/9/85) and EBM/85/126 (8/26/85).

6. CHILE - EXTENDED ARRANGEMENT - EFFECTIVE DATE

1. The Fund notes the arrangements made for the financing of Chile's expected balance of payments deficit until July 14, 1986 described in EBS/85/122, Supplement 4, and finds that these arrangements are satisfactory.

2. Accordingly, the extended arrangement for Chile set forth in EBS/85/122, Supplement 3, shall enter into effect on August 15, 1985.

Decision No. 8057-(85/126), adopted
August 15, 1985

7. YUGOSLAVIA - STAND-BY ARRANGEMENT - REVIEW OF EXTERNAL FINANCING ARRANGEMENTS

The Fund has been informed of the substantial progress of negotiations for the refinancing by Yugoslavia of maturities falling due during the period from January 1, 1985 until the expiration of the stand-by arrangement. In the light of this information, the Fund determines, for the purpose of purchases phased for the period before November 29, 1985 only, that the requirement in paragraph 4e of the stand-by arrangement is met. (EBS/85/197, 8/20/85)

Decision No. 8058-(85/126), adopted
August 23, 1985

8. ARGENTINA - REPRESENTATIVE RATE FOR ARGENTINE AUSTRAL

The Fund finds, after consultation with the authorities of Argentina, that the representative exchange rate for the Argentine austral under Rule O-2(b)(i) against the U.S. dollar is the midpoint between buying and selling rates for spot delivery of U.S. dollars in the official exchange market. (EBD/85/207, 8/8/85)

Decision No. 8059-(85/126) G/S, adopted
August 14, 1985

9. TONGA - MEMBERSHIP - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/85/166, Sup. 1, 8/13/85) on the canvass of votes of the Governors on Resolution No. 40-2, with respect to membership for Tonga, approved by the Executive Board for submission to the Board of Governors (EBM/85/105, 7/12/85). The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		822,532
Total negative votes		0
Total votes cast		822,532
Abstentions recorded	0	
Other replies	0	
Total replies		822,532
Votes of members that did not reply		107,486
Total votes of members		930,018

Decision No. 8060-(85/126), adopted
August 13, 1985

10. SWAZILAND - TECHNICAL ASSISTANCE

In response to a request from the Government of Swaziland for technical assistance to review and revise the banking laws in Swaziland, the Executive Board approves the proposal set forth in EBD/85/210 (8/12/85).

Adopted August 16, 1985

11. ANNUAL REPORT, 1985

The Executive Board approves the transmittal of Chapters 1, 2, and 3 and Appendices I-IX of the 1985 Annual Report to the Board of Governors under cover of the letter set forth in EBD/85/108, Supplement 1 (8/15/85).

Adopted August 19, 1985

12. RECENT DEVELOPMENTS IN DEBT RESTRUCTURING - PUBLICATION

The Executive Board approves the proposal for the publication, in the series of Occasional Papers, of a staff paper entitled "Recent Developments in Debt Restructuring" as set forth in EBD/85/201 (8/1/85).

Adopted August 15, 1985

13. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the consultations with the CONTRACTING PARTIES to the GATT on Portugal, Sri Lanka, and Turkey to be held in Geneva, October 7-11, 1985, as set forth in EBD/85/209 (8/12/85).

Adopted August 15, 1985

14. 1985 ANNUAL MEETING - FORMAL NOTICE AND BRIEF AGENDA

The Executive Board instructs tht Secretary to communicate the formal notice and brief agenda for the 1985 Annual Meeting by cable and by airmail letter to all Governors and Alternate Governors. (EBD/85/197, 7/29/85)

Adopted August 14, 1985

15. PENSION COMMITTEE - INVESTMENT ADVISOR - ESTABLISHMENT OF POSITION

The Executive Board approves the recommendation for a new position of Investment Advisor in the Office of the Managing Director as set forth in EBAP/85/196 (7/29/85) and EBAP/85/196, Supplement 1 (8/2/85).

Adopted August 9, 1985

16. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to Executive Director as set forth in EBAP/85/209 (8/8/85).

Adopted August 12, 1985

17. APPROVAL OF MINUTES

a. The minutes of Executive Board Meeting 84/162 are approved. (EBD/85/203, 8/5/85)

Adopted August 9, 1985

b. The minutes of Executive Board Meetings 84/163 and 84/164 are approved. (EBD/85/208, 8/12/85)

Adopted August 19, 1985

c. The minutes of Executive Board Meetings 84/165 through 84/169 are approved. (EBD/85/211, 8/14/85)

Adopted August 21, 1985

18. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, as set forth in EBAP/85/210 (8/8/85), EBAP/85/211 (8/9/85), EBAP/85/212 (8/12/85), EBAP/85/215 (8/14/85), EBAP/85/216 (8/16/85), EBAP/85/219 (8/20/85), EBAP/85/220 (8/21/85), and EBAP/85/222 (8/22/85), by Advisors to Executive Directors as set forth in EBAP/85/210 (8/8/85), EBAP/85/211 (8/9/85), and EBAP/85/219 (8/20/85), and by Assistants to Executive Directors as set forth in EBAP/85/218 (8/19/85) and EBAP/85/221 (8/22/85) is approved.

APPROVED: May 8, 1986

LEO VAN HOUTVEN
Secretary