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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/141

10:00 a.m., September 13, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| A. Alfidja | Mawakani Samba |
| C. H. Dallara | M. K. Bush |
| | M. Lundsager, Temporary |
| J. de Groote | |
| B. de Maulde | S. de Forges |
| M. Finaish | T. Alhaimus |
| | H. Kobayashi, Temporary |
| G. Grosche | B. Goos |
| J. E. Ismael | |
| R. K. Joyce | L. Leonard |
| | G. W. K. Pickering, Temporary |
| | H. A. Arias |
| T. P. Lankester | T. A. Clark |
| H. Lundstrom | H. Fugmann |
| E. I. M. Mtei | A. Abdallah |
| F. L. Nebbia | |
| Y. A. Nimatallah | J. E. Suraisry |
| P. Pérez | |
| J. J. Polak | J. de Beaufort Wijnholds |
| C. R. Rye | A. V. Romuáldez |
| G. Salehkhou | O. Kabbaj |
| A. K. Sengupta | A. S. Jayawardena |
| S. Zecchini | N. Coumbis |
| Zhang Z. | Jiang H. |

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

Also Present
IBRD: R. Agarwala, Special Office for African Affairs, D. R. Bock, Director, Financial Policy and Analysis Department, V. Dubey, Country Policy Department; P. Landell-Mills, K. Lateef, Western Africa Regional Office. African Department: G. E. Gondwe, Deputy Director; M. Allen, D. T. S. Ballali, W. Bier, E. L. Bornemann, E. A. Calamitsis, R. O. Carstens, S. E. Cronquist, L. D. Dicks-Mireaux, M. G. Fiator, J. R. Hill, I. Kapur, J. W. Kratz, D. E. Syvrud. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; J. T. Boorman, S. Kanesa-Thasan, N. Kirmani, G. G. Johnson, B. J. Nivollet. External Relations Department: A. F. Mohammed, Director. IMF Institute: J. M. Davis; F. A. Quarshi, Participant. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Deputy General Counsel; A. O. Liuksila, S. A. Silard. Middle Eastern Department: J. G. Borpujari. Research Department: W. C. Hood, Economic Counsellor and Director; D. J. Andrews, K.-Y. Chu, N. M. Kaibni, A. Mullor-Sebastian, M. A. Wattleworth. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, J. A. Gons, D. Gupta, A. F. Moustapha, D. V. Pritchett, T. M. Tran, P. van den Boogaerde, G. Wittich, B. B. Zavoico. Bureau of Statistics: S. H. Hahn. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: P. E. Archibong, L. K. Doe, D. Hammann, J. Hospedales, G. Nguyen, J.-C. Obame, P. Péterfalvy, M. Z. M. Qureshi, T. Sirivedhin, N. Toé, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, M. B. Chatah, J. de la Herrán, A. K. Diaby, J. J. Dreizzen, G. Ercel, C. Flamant, S. Geadah, N. Haque, G. D. Hodgson, L. Hubloue, Z. b. Ismail, S. Kolb, J. A. K. Munthali, K. Murakami, A. H. Mustafa, E. Olsen, M. Rasyid, J. Reddy, D. J. Robinson, M. Sarenac, B. Tamami, A. J. Tregilgas, E. L. Walker, B. D. White, Yang W., A. Yasseri.

1. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR SEPTEMBER-NOVEMBER 1985

The Executive Directors considered the proposed designation plan (EBS/85/208, 8/30/85) and operational budget (EBS/85/209, 8/30/85) for the quarterly period September-November 1985.

The staff representative from the Treasurer's Department noted that further transactions with designation of about SDR 16 million had taken place since the proposed designation plan had been issued. The changes in the designation plan and some others in the operational budget were small and would be reflected in supplements to the staff papers.

Mr. Rye indicated that he wished to raise a point of principle that was not related specifically to the plan and the budget under consideration, with which he had no disagreement. The issue had arisen in the context of the sharp deterioration in Australia's external position that had taken place early in 1985. As the Australian dollar was virtually free floating, with minimal intervention by the authorities, the effects of that deterioration had been manifested very largely in the exchange rate--which had depreciated in trade-weighted terms by almost 20 percent within a few weeks--rather than in any loss of reserves. Exchange rate movements were clearly an important indicator of a country's payments position, particularly one with a floating exchange rate regime. The exchange rate "can signal an improving or deteriorating payments position earlier than other quantitative indicators, such as changes in reserves."

However, Mr. Rye continued, "developments in the exchange markets" were not listed as a criterion for evaluating the balance of payments position of a country for possible inclusion in the designation plan in Article XIX, Section 5(a)(i). While "developments in the exchange markets" were a listed criterion in Article V, Section 3(d) for inclusion in the operational budget, it seemed clear that the staff placed comparatively little weight on such developments--generally only assigning to them the status of background information.

It was also his understanding that the staff looked at the overall balance of payments position rather than the current account, Mr. Rye added. Such a practice seemed to be open to some question in a country with a floating exchange rate, because, by definition, the capital account would offset the current account (in the absence of official transactions). Inclusion in the designation plan and operational budget involved a potential change in the composition of reserves rather than any change in their level. Nonetheless, the change in composition of reserves did have implications, albeit marginal, for the liquidity of reserve holdings and therefore for the ability of a government to intervene in the market.

He was not implying that that consideration was pertinent to Australia's present circumstances, Mr. Rye pointed out. On the contrary, the authorities readily acknowledged that Australia's reserves were more than adequate, and they had no objection to the inclusion of their dollar in the designation plan and operational budget for the September-November period. They had asked him, however, to bring to the attention of the Executive Board and the staff for later consideration, rather than for an immediate response, the question of whether exchange rate developments should not play a greater role in the determination of currencies for inclusion in the designation plan and operational budget.

Mr. de Maulde said that he had no problem with either the designation plan or the operational budget. However, his authorities had not received the staff papers as of September 12, 1985, and he asked if it would be possible in future to have additional time to consider such items.

The Secretary replied that such papers were normally issued about two weeks before the Executive Board considered them, although on a number of occasions the Board had considered designation plans and operational budgets with a shorter lead time. The Communications Division would be able to ensure rapid delivery of the documentation to Paris, if Mr. de Maulde wished.

Mr. Salehkhou said that he had received no communication from his authorities regarding the inclusion of Algeria in the designation plan but that, given the small amount involved, it must have been acceptable to them.

Mr. Suraisry stated that he supported the proposed decisions.

The staff representative from the Treasurer's Department, in response to Mr. Rye, said that the staff had discussed the matter with Mr. Rye and that the exchange rate developments were taken into account in the overall examination of members' external positions. The issues raised by Mr. Rye would be kept under review by the staff.

To respond to Mr. de Maulde's question of timing, the staff representative indicated that although the staff made every effort to issue the papers as early as possible, it preferred to include the data for the previous month, which normally were not available until fairly late in the month in which the proposed designation plan and operational budget were submitted to the Board.

Mr. Polak commented that he understood the operational constraints on the staff. He had found that his authorities were interested in only a few of the numbers, and those numbers could be telexed, thus avoiding difficulties due to the delayed receipt of the staff papers.

The Executive Board then adopted the following decisions:

SDR Department - Designation Plan for September-November 1985

The Executive Board approves the designation plan for the quarterly period beginning September 13, 1985 as set out in EBS/85/208 (8/30/85).

Decision No. 8077-(85/141)S, adopted
September 13, 1985

Operational Budget for September-November 1985

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/85/209, page 3, footnote 1 and the operational budget for the quarterly period beginning September 13, 1985, as set out in EBS/85/209 (8/30/85).

Decision No. 8078-(85/141), adopted
September 13, 1985

## 2. CHAD - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a staff paper on the request from Chad for a purchase in the amount equivalent to SDR 7.0 million under the compensatory financing facility (EBS/85/200, 8/22/85; Sup. 1, 9/12/85).

Mr. Alfidja indicated that Chad's export earnings were forecast to decrease by 38 percent because of a projected sharp drop in external receipts from cotton exports. Despite the decrease in imports, the current account deficit was forecast to widen sharply, hence leading to a large overall deficit in the balance of payments in 1985. The contributory factors to the prospective erosion of the external account had been well documented in the staff report. The staff had also provided ample evidence of Chad's cooperation with the Fund in an attempt to find a solution to the economic and financial difficulties confronting the country.

As recommended by the staff, the Chad authorities had taken stringent steps to keep the wage bill down and had established quarterly ceilings on spending, Mr. Alfidja remarked. They were expecting a Fund mission late in October 1985 to pursue negotiations on a comprehensive financial program that could be supported by the Fund. The projected shortfall in exports, due to unfavorable weather conditions and lower prices, was beyond the control of the Chad authorities and was expected to be temporary.

Mr. de Maulde noted that the request by Chad for a purchase under the compensatory financing facility was straightforward and met all the relevant criteria. A balance of payments need existed, and the export shortfall was completely beyond the control of the authorities. It had been caused mainly by the severe drought, which had affected all of the sub-Saharan countries during the past year and which, in Chad, had been exacerbated by internal disturbances in the cotton-growing areas of the southern part of the country.

Chad had fully met the test of cooperation with the Fund and would in fact, have met the more stringent requirements for a purchase in a higher compensatory financing tranche, had the amount of the shortfall justified it, Mr. de Maulde added. A first indication of the country's will to cooperate with the Fund was Chad's prompt repayment--assisted by the other members of the monetary union to which it belonged--of overdue obligations to the Fund that had emerged for a short period in 1984. Since that time, Chad had remained current, which testified to the will of the authorities to meet their obligations. That had not been an easy task for a country facing so many constraints. Moreover, Chad's performance made the situation of certain countries with significant arrears to the Fund all the harder to understand, since those countries had far higher per capita incomes than Chad and, thus, had many more resources with which to pay the Fund.

The quality of Chad's cooperation with the Fund was exemplified by the serious adjustment effort in which the authorities were engaged, Mr. de Maulde continued. Moreover, they were at the same time launching structural reforms aimed at rebuilding Chad's economy and administration, after years of disruptions due to civil strife. In that connection, the Government continued to have recourse to the Fund's technical assistance, to help in the design of suitable policies.

The fiscal effort deserved particular commendation, Mr. de Maulde suggested; the authorities had implemented virtually all the fiscal measures recommended by the Fund, although total government expenditure was only 10 percent of GDP and civil servants were on half pay. On the supply side, producer prices for cotton had doubled in three years; he therefore, asked the staff whether it might not have been a little too conservative in its projections for future levels of cotton production and harvest. He hoped that the negotiations to take place shortly, pursuant to Chad's request for a stand-by arrangement, would be successful.

To his knowledge, Mr. de Maulde said that, the International Development Association had made no loans in Chad during the past six years, and he would welcome comment by the staff of the World Bank concerning the plans of the World Bank and IDA for future activities in Chad.

Mr. Abdallah noted that Chad's request met all the conditions for use of Fund resources under the compensatory financing facility. The magnitude of the balance of payments need was evident from Table 1. Both the current account and the overall balance were expected to slip into deficit in 1985; despite an improvement in long-term capital flows resulting from debt relief, the worsening overall position was expected to lead to a drawdown of Chad's external reserves. The pressure on the balance of payments was perhaps most obvious in the buildup of external arrears up to 1984.

The shortfall in export earnings had occurred because of the severe and prolonged drought that had afflicted much of Africa, Mr. Abdallah observed, and it was completely beyond the control of the authorities. Cotton production, which constituted Chad's main economic activity, had fallen markedly in 1984-85 in spite of continued efforts by the authorities to strengthen producer price incentives. At the same time, international price developments for cotton had not helped the situation. Nevertheless, barring adverse weather conditions, output was expected to recover in the two postshortfall years; the estimated average increase in total export earnings for 1984 and 1985 appeared attainable.

Chad had also met the test of cooperation with the Fund, Mr. Abdallah commented. Since the conclusion of the 1985 Article IV consultation in April 1985, the authorities had been able to implement a wide range of revenue-raising and expenditure-saving measures aimed at reducing internal and external imbalances that were in line with the recommendations made by the staff. Those measures, as well as others under consideration, constituted a strong adjustment program. A request from Chad for a stand-by agreement would merit support if a precise stabilization program were drawn up.

Amplification from the staff on the mechanics of the proposal to block a certain amount of the compensatory financing purchase to meet repurchases falling due after March 1987 would be helpful, Mr. Abdallah concluded. The proposed procedure appeared to open up a new policy direction, which might have implications for other members.

Mr. Goos remarked that in a technical sense he agreed with previous speakers that Chad had met the relevant criteria for a purchase under the compensatory financing facility: the balance of payments need could hardly be contested; the shortfall seemed largely beyond the country's control; and the authorities intended to cooperate with the Fund. However, the requested drawing raised questions that extended beyond the compensatory financing decision, touching on more fundamental principles of Fund policy. The questions were related to the accumulation by the Chad authorities of external arrears in the past two years that were still outstanding. Because those arrears had emerged when Chad had had considerable balance of payments surpluses, considerable doubts had arisen about the authorities' ability to honor their external obligations. The Executive Board could not ignore such an issue in assessing Chad's present request for a compensatory drawing, the more so because it had been in arrears to the Fund.

Against that background and in view of the country's extremely difficult economic situation, Mr. Goos questioned whether the Fund's relatively short-term and costly resources were an appropriate form of balance of payments financing for Chad. It would be most unfortunate if, by extending such financing, the Fund exacerbated the country's financial problems, thereby creating another case of potential arrears to the Fund.

Moreover, it was not certain whether Board approval of the requested drawing--despite the existence of external arrears--would be consistent with more fundamental principles of Fund policy, Mr. Goos continued. It was true that the compensatory financing decision contained no reference to external arrears that would prevent drawings. Nonetheless, in permitting such a drawing, the Board might be interfering with one of the most fundamental mandates laid out in the Articles of Agreement--to keep the multilateral payments systems free from restrictions and to eliminate exchange restrictions that hampered trade (Article I(iv)). It was on the basis of that mandate that the Fund usually insisted on firm understandings regarding the elimination of external arrears before entering into arrangements with members; any breach of such understandings automatically led to a suspension of the right to draw under the arrangement.

Any comment on how the generally firm treatment of external arrears could be reconciled with the rather lenient approach in Chad's case would be welcome, Mr. Goos added. While it was clear that the authorities were working with the staff to find a solution to the country's external problems, one would have thought that any use of Fund resources would require as a minimum an explicit understanding regarding the elimination of external arrears. However, the Chad authorities had set only a general policy objective for 1985, which provided for a modest reduction in arrears. The issue was so important that Mr. Goos preferred to reserve his position on the requested drawing until a more satisfactory explanation by the staff had been provided.

The staff representative from the Exchange and Trade Relations Department responded that certain unusual features needed to be mentioned in regard to Chad's arrears. As in many other countries belonging to a monetary union, Chad's arrears had arisen not because of a governmental limitation on the availability of foreign exchange but because of the nonavailability of domestic currency, linked to the limits placed by the Bank of Central African States (BEAC) on financing by the Government.

In a strict jurisdictional sense, therefore, the arrears did not constitute exchange restrictions and were not subject to approval by the Fund, the staff representative added. From the point of view of use of Fund resources, the existence of arrears had always been regarded as a matter for concern, and had almost always involved understandings on the elimination or reduction of such arrears. In that context, the forthcoming discussions between Chad and the staff on the possible use of Fund resources would call for understandings to be reached on the elimination of Chad's arrears. In fact, the appraisal in the staff report under discussion contained a sentence indicating that the authorities intended to meet in full all debt service obligations due in 1985, and that they would avoid any further accumulation of arrears, domestic or foreign.

Finally, the staff representative noted, members were not debarred from making use of the Fund's resources if they maintained unapproved restrictions. Several members maintaining such restrictions had made purchases under the compensatory financing facility. However, in the case of Chad, it was important to bear in mind that the arrears were not an exchange restriction subject to Fund approval.

Mr. Goos expressed surprise that there were precedents for drawings despite the maintenance of restrictions. The topic might be a suitable subject for future discussion because it seemed to be in conflict with a basic mandate of the Fund. If, in a legal sense, Chad had no restrictions, then he would approve the decision; in a strict economic sense, the situation was not entirely satisfactory. The authorities had committed themselves not to accumulate new arrears, but had made no firm commitment on how they intended to reduce the existing arrears; a more explicit plan for eliminating those arrears would have been appropriate.

Mr. de Maulde suggested that Mr. Goos's point was well taken but premature. The Executive Board should take up the issue when it considered Chad's request for a stand-by arrangement, which was said to be forthcoming, as drawings under the compensatory financing facility apparently did not involve the same kind of conditionality that would be required for drawings under a stand-by arrangement.

The staff representative from the African Department stated that the Chad authorities had been informed that a stand-by arrangement would require them to adopt a plan for the elimination of the arrears as a part of any new program. The authorities had indicated their acceptance of that requirement.

Mr. Coumbis noted that all the prerequisites for a compensatory financing facility purchase had been fulfilled. There was a balance of payments problem, since the current account had deteriorated significantly in 1985; for the whole year the deficit was projected to be about SDR 43.0 million, against current account surpluses in 1983 and 1984. Moreover, Chad was cooperating very closely with the Fund. The authorities had already taken a number of measures recommended by the staff mission and they were formulating, with the assistance of the Fund, a financial program for 1986 that could be supported by a stand-by arrangement.

The authorities also intended to satisfy all debt service obligations due in 1985 and to avoid any further accumulation of arrears, Mr. Coumbis added. The shortfall for the year ended May 1985 had been SDR 7.0 million, due mainly to a decline in earnings from lower exports of cotton, which accounted for about four fifths of total exports. The basic cause of the reduction in cotton exports had been a severe drought, which had affected other exports as well. The shortfall could be considered temporary and due to factors beyond the country's control.

Like Mr. de Maulde, Mr. Coumbis expressed interest in learning about the plans of the World Bank in Chad.

Ms. Lundsager indicated that Chad's balance of payments position had been eroded, due in large part to the drought-induced decline in exports of cotton, which indicated that the shortfall was largely beyond the control of the authorities. As Mr. de Maulde had pointed out, Chad was requesting a relatively small purchase, and thus had to meet a much lower test of conditionality in terms of cooperation with the Fund. Even though a program was not yet in place, the authorities were implementing a number of measures that did meet the test of cooperation, notably, wage restraint and other expenditure cuts. Moreover, credit was being restrained, and the authorities were maintaining their commitment to increase consumer and producer prices as needed during the year, as well as to avoid the emergence of new arrears. She had been glad to have confirmation from the staff that the new program that was under discussion would include a plan for the reduction of existing arrears.

Echoing Mr. Abdallah's earlier remark, Ms. Lundsager expressed concern about the procedure set up for placing in a special account sufficient monies from the compensatory purchase to maintain Chad current with the Fund through early 1987. Her concern stemmed from the fact that, given Chad's budgetary difficulties, debt service should be included as part of the formal budget operations. The fact that a special procedure had been necessary indicated that Chad still had serious budgetary difficulties. It might have been prudent to consider the request for the compensatory financing facility purchase concurrently with that for the stand-by arrangement, to permit ample discussion of administrative procedures that would ensure a permanent regularization of external payments.

As it appeared to be an appropriate time for the World Bank to resume its operations in Chad, further information about the Bank's plans would be welcome, Ms. Lundsager concluded.

Mr. Clark said that the request was within the normal terms of the compensatory financing facility, although he shared the concerns that had been expressed by others; he also wished to have a technical point clarified. The compensatory financing facility was designed to compensate for export shortfalls below trends; however, Tables 3 and 4 in the staff report seemed to indicate that what was being compensated was a return to trend after an exceptionally good year in 1984. Could the staff comment on that?

Mr. Pickering indicated that Chad's request met all the criteria for a drawing under the compensatory financing facility. In view of the past history of Chad's relations with the Fund, however, one tended to focus on the member's cooperation with the Fund, which was dealt with in the section of the staff report that included the references to the blocked account. He understood that the Fund, if it was to help its members by providing its resources, needed to make adequate provisions to safeguard those resources. But, he shared Mr. Abdallah's concerns about the consequences of the initiative to set up a blocked account, which seemed to be a new procedure. The staff might want to consider addressing the issue in its next six-month review on overdue obligations. He also shared Mr. Goos's concerns about Chad's use of Fund resources despite the existence of external arrears.

The staff representative from the African Department noted that, as the staff report had pointed out, the financing gap in the budget for fiscal 1985 was CFAF 1.6 billion, or about SDR 3.5 million. The remaining SDR 3.5 million would be blocked for the 15 months from the start of 1986 into 1987. Basically, the blocking served the purpose of limiting the financing of the budget, thereby avoiding any slippage in fiscal performance resulting from use of the counterpart funds. Moreover, as many Directors had pointed out, the procedure gave the Fund greater assurance regarding repurchases. As for the implications for other Fund members, the suggestion that it should be discussed further was well taken.

The Chairman recalled that during an earlier discussion of Chad's situation, it had been explained that, although the external reserves of the BEAC were very large--technically speaking they were unlimited--it was impossible for Chad to repay its arrears because of the BEAC rule that limited a country's access to local currency to a certain percentage of its fiscal receipts for the preceding year. Because of the concern expressed by Executive Directors at that time, management and staff had tried, with the full cooperation of the Chad Government and the BEAC, to avoid the recurrence of that problem. The domestic funds that were the counterpart of the compensatory drawing would be lodged in a special account with the central bank to enable Chad to repurchase from the Fund even if it neared its credit limit in the central bank. The Board's reaction to the proposed procedure was perplexing. The method was not new, and it provided a way to resolve the dilemma of a country that had been unable to settle arrears within the specific context of its central banking arrangements. Moreover, the procedure had the full support of the Chad authorities.

The staff representative from the Research Department, in response to Mr. de Maulde's suggestion that projections for cotton were pessimistic, noted that the size of the projected recovery in the cotton sector was made with reference to a longer-term trend dating back to the early 1970s. Output had increased very sharply in 1984 before being adversely affected by drought in 1985. The volume of cotton exports in the two postshortfall years was projected to be almost 20 percent above the level of the shortfall year.

As Mr. Clark had pointed out, Chad was apparently being compensated for a return to trend in exports after an exceptionally good year in 1984, the staff representative noted. In accordance with the formula applied since 1975 the medium-term trend, from which the shortfall was calculated, was a five-year geometric average centered on the shortfall year. In the case of Chad that trend, and thus the size of the shortfall, was affected by the high level of exports in 1984; the trend would continue to be influenced by high exports in 1984, until that year no longer figured in its calculations.

The staff representative from the World Bank said that the Bank had not approved any new credits for Chad since 1979. The World Bank staff had been concerned for the past two or three years about the serious implementation problems with respect to ongoing projects; moreover, the security situation had precluded the launching of new projects. Recently, however, the staff had had some promising discussions with the Government of Chad, and was examining the possibility of exploiting Chad's significant oil resources. A large mission would explore, over the six weeks ahead, the feasibility of a reconstruction project of some size, at the same time updating economic information on Chad.

Mr. Goos said that in his earlier remarks he had not been referring particularly to the freezing of the counterpart funds; he did support the imaginative solution that the management and staff had devised to avoid the recurrence of arrears.

Mr. Pickering clarified his earlier remarks by noting that the counterpart blockage was an unusual provision that might have consequences that should be considered within the context of a broader review of the Fund policy on overdue obligations.

The Chairman observed that arrears usually occurred because a country did not have adequate foreign exchange. Chad, however, had ample foreign exchange but lacked local money because of the very specific rules applied by its multicountry central bank, which prohibited access to local resources beyond certain limits. The technical problem had been to ensure the availability of the local currency. Chad, the BEAC, and the Fund had agreed on a means of providing such assurance. It was a solution adapted to a specific situation and was not necessarily applicable on a broader basis.

Nonetheless, the Chairman continued, Ms. Lundsager had rightly observed that if Chad had had its budgetary situation fully under control, it could have met the rule on maximum access to central bank financing. More work remained to be done to resolve some of Chad's underlying problems. The Fund had not yet reached agreement on a program with the Chad authorities and probably would not be able to assess the budgetary situation fully until an overall program was in place. In the meantime, the Fund was willing to provide assistance through the compensatory financing facility, which would involve less conditionality. That approach had seemed to be consistent with the express wish of many Directors that the Fund should grant some compensatory financing drawings that were not necessarily linked to the use of Fund resources in the upper credit tranches, provided the member satisfied the appropriate cooperation test.

Mr. Alfidja confirmed the Chairman's understanding. The Chad authorities had discussed the proposal for blocking counterpart funds and had been willing to accept it. Indeed, the Minister had expressed his hope that the proposed solution would take care of the earlier concerns of Executive Directors. The Board should encourage the Chairman to continue taking an imaginative approach to specific cases, such as the one exemplified by Chad, rather than to become locked into a standard approach. Finally, Chad had come a long way, and merited some encouragement in its efforts.

The Executive Board then took the following decision:

Chad - Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Chad for a purchase of SDR 7.0 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979, as amended).

2. The Fund notes the representation of Chad and approves the purchase in accordance with the request.

Decision No. 8079-(85/141), adopted
September 13, 1985

## 3. GHANA - 1985 ARTICLE IV CONSULTATION AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1985 Article IV consultation with Ghana and the second review under the 16-month stand-by arrangement approved in August 1984 (EBS/85/211, 8/20/85). They also had before them a report on recent economic developments in Ghana (SM/85/252, 9/4/85).

The staff representative from the African Department remarked that when the staff report had been issued, preliminary data indicated that all of the performance criteria for June 1985 had been met; those preliminary indications had since been confirmed.

In addition, in their letter dated August 27, 1985 the Ghanaian authorities had stated their intention to raise all deposit rates by 1 percentage point and all lending rates by 1/2 percentage point as of September 2, 1985, the staff representative continued; the rates had been raised effective September 10. Moreover, given the containment of inflation, it appeared likely that the authorities would meet their objective of having positive real interest rates by end-1985 or mid-1986 at the latest. The staff did not expect an upsurge in deposits, however, because of what had happened in 1982, when all deposits in excess of ₵ 50,000 had been blocked, an experience that continued to affect confidence in the banking system. Nevertheless, the upward adjustments in the interest rates were major steps in the right direction.

Mr. Salehkhou made the following statement:

After about ten years of deteriorating economic conditions and of continued postponement of a decisive adjustment action to adapt the economy to the changing international environment and to reverse the trend of widening financial imbalances and structural distortions, the authorities in Ghana engaged in a major correction program early in 1983. The program carried substantial support from the Fund and the World Bank and impressive measures were implemented at the start of the program. The major objectives of the 1983 adjustment policies related to the restoration of normal price relationships, rehabilitation of the economy's traditional export sector and the curtailment of the fiscal deficit as well as excessive bank financing. These were all necessary steps to resume economic growth and rebuild domestic and external confidence.

Although some progress was recorded under the first stand-by arrangement, and despite a rather favorable preliminary response from Ghana's creditors and donors, the 1983 adjustment program was less successful than expected in the rehabilitation of the productive base of the economy and the restoration of adequate supply as the magnitude of deterioration and structural bottlenecks were probably underestimated. Nonetheless, by 1984, and after the adoption of the initial gains of the adjustment policies and the acceleration of rehabilitation efforts, Ghana had achieved a broad-based economic recovery as real GDP growth reached 7.6 percent, largely in response to the adjustment program and due to the bumper harvest and favorable climatic condition. Government budget deficit was reduced from 4.5 percent of GDP in 1982 to 1.8 percent of GDP in 1984 with the authorities taking a number of additional discretionary measures to comply with commitments under the adjustment program and significantly curtail bank financing of the deficit. The inflation rate was considerably brought down to 40 percent in 1984, compared with 123 percent in 1983 when large price and exchange rate adjustments had been introduced. Finally, in spite of an official assistance program falling substantially short of the Fund's and the authorities' initial projections, Ghana was able to reduce by more than half its external payments arrears, which were $232 million in 1984, compared with $577 million in 1982.

The economic and financial program for 1985, which continues the thrust of the initial adjustment policies, is particularly cognizant of the need for rebuilding infrastructure and completing the rehabilitation of the export sector. The attainment of the program objectives in 1985 should be facilitated by a projected increase in foreign financing on concessional terms. It also entails the adoption of strong measures, including a further significant depreciation of the cedi, a substantial increase in cocoa producer price, the virtual elimination of price control, and a major domestic resource mobilization. While the program for 1985 should result in a widening of both the fiscal and external current account deficits to accommodate the projected doubling of development expenditures, the policies and measures implemented should also enable Ghana to significantly contain inflationary pressures by reducing the consumer price index increase to 20 percent in 1985 from 40 percent in 1984, to achieve a 5.3 percent real GDP growth, and to further reduce external payments arrears.

Ghana's economic and financial performance under the current program has so far been satisfactory and largely in accordance with the original targets. As with the previous Fund arrangement, the authorities have, in addition to meeting all the related performance criteria, also implemented a number of supplementary measures to adapt to unforeseen developments.

Notwithstanding a lower cocoa crop in 1984/85 than originally expected, the 1985 objective of 5.3 percent of real GDP growth is viewed achievable, as cocoa and industrial crop farmers continue to respond to higher producer prices and as significant progress is being recorded in the rehabilitation of infrastructure and the realization of the import program. The impact of the measures implemented since 1983 on export industries also seems to be encouraging, particularly with respect to manganese and bauxite production, although the projected recovery in timber and gold production had to be revised downward.

Price developments are also within the 20 percent program target, largely due to the improved general supply situation, the continuation of cautious management policies, and greater competition of some local supplies with imports. It should be noted, however, that despite the containment of inflation and the significant general salary increase granted at the end of 1984, real wages remain at less than half the 1978 level. While the authorities do not intend to grant a new general salary increase in 1985, efforts are concentrated in the civil service and major public enterprises on encouraging workers' redeployment toward productive sectors.

The latest adjustment of the exchange rate last month brought the real depreciation of the cedi since 1983 to more than 80 percent. The authorities have also recently intensified export promotion efforts, particularly through the allocation of import licenses to export-oriented industries, improved monitoring of export rehabilitation programs, and generally more flexible foreign exchange regulations. Together with higher producer prices, the authorities' external policies have permitted an expansion of exports and the realization of increased, though insufficient, imports.

Despite these positive developments, however, exports in 1985 are now projected to be lower than estimated earlier this year, due mostly to the downward revision of earnings from cocoa, which has forced a reduction in the projected level of imports. After such revisions, the external current account deficit is now expected to be even lower than the program target.

In line with commitments under the Fund program, Ghana has also met the performance criteria with respect to new borrowing and has reduced external payments arrears at a slightly more accelerated pace than targeted.

The 1985 budget aims at accommodating a level of development expenditures more in line with the program rehabilitation and growth targets. While the overall fiscal deficit in terms of GDP is to increase from 1.8 percent in 1984 to 2.3 percent in 1985, bank financing of the budget should continue to decline, reflecting the higher contribution of foreign financing and, more importantly, the implementation of major domestic resource mobilization measures, which were projected to yield $4.9 billion in 1985.

Actual developments in the first half of 1985 indicate that, while budget expenditures seem to be broadly on track as earlier assumptions of foreign and domestic financing can be retained, a significant shortfall in government revenues can be expected, particularly in view of less favorable balance of payments developments and lower-than-expected sales of excisable commodities.

To achieve the original overall deficit target, the authorities have again resorted to additional discretionary measures to prevent the expected revenue shortfall. New measures include the institution of a road tax and higher hospital fees and charges, as well as some savings on budgeted expenditures and lending. With the additional measures, the authorities intend to avoid as much as possible any cut in their development program.

Monetary developments have been broadly in line with the program targets and call for no revision since the basic macroeconomic assumptions with respect to GDP growth, balance of payments deficit, inflation, and budget financing remain valid.

In spite of the expected success of the current stand-by arrangement, Ghana's prospects for achieving a stable economic growth and viable balance of payments by 1990 will continue to depend not only on the pursuit and strengthening of structural adjustment policies and the maintenance of favorable international prices for its traditional exports but also on its ability to attract sufficient capital flows at concessionary levels to strengthen rehabilitation programs and the economy's general supply situation without an excessive debt service burden.

The medium-term scenario described in the staff report entails the persistence of significant financing needs through the decade. In this regard, the authorities concur with the Fund and World Bank staff about the need for medium-term development strategy to gather enough external support for the financing of the projected gap. They also hope that, with the technical assistance provided by the two institutions, such a strategy could be presented to the Consultative Group meeting to be held in November.

Mr. Goos commended the authorities for their continued and successful effort to implement the adjustment program, which had remained on track. It was particularly heartening to learn that the authorities had responded in a flexible and resolute manner to the expected export shortfall, thereby offsetting its negative effects on the fiscal position and the overall balance of payments deficit, while reducing the external arrears through June 1985 by a higher amount than originally envisaged.

The adjustment effort was beginning to bear fruit, as suggested by the overall growth performance and the revival of investment activity in the framework of a strongly decelerating inflation rate, Mr. Goos observed. Nevertheless, there was no room for complacency, particularly in view of the revisions to the medium-term scenario. The increase in the residual financing requirement in the years ahead, which exceeded the already high figures previously projected, was certainly a matter for concern and called for perseverance in the adjustment effort. Moreover, the disappointing performance of private capital flows suggested that more should be done to regain the confidence of private foreign investors. The authorities should adopt the staff recommendations and should continue to mobilize domestic savings, strive for positive real interest rates, and maintain an appropriately restrictive stance on financial policies. To improve the country's medium-term prospects, the authorities should place particular emphasis on the staff recommendations to encourage cocoa production and export diversification.

Mr. Alfidja said that the serious adjustment effort initiated a few years previously by the Ghanaian authorities had resulted in a remarkable performance of the economy during the past year. Following the successful implementation--with Fund and World Bank support--of its previous economic and financial program, Ghana was continuing to make satisfactory progress under the current adjustment program. The negative growth rates recorded before 1983 had been reversed, and real GDP had increased substantially for the first time in six years. The accompanying significant reduction in the rate of inflation reflected not only the improved weather conditions, which had contributed to a substantial rise in the output of foodcrops and cocoa, but also the strict implementation of cautious, yet flexible demandmanagement policies. In addition to a substantial decline in the rate of expansion of domestic liquidity, public confidence in the banking system had been revived, thus enhancing the prospects for mobilization of domestic financial resources. The pressure on the payments position had eased considerably and inflows of offshore, long-term capital had shown an encouraging trend.

The authorities should continue their courageous and vigorous adjustment effort in order to maintain a positive rate of GDP growth and to make further progress toward a viable balance of payments position in the medium term, Mr. Alfidja stated. The staff had correctly indicated that achievement of that goal would depend on the inflow of sufficient foreign resources to finance much-needed imports, and on Ghana's progress in diversifying the economy's export base and providing favorable price incentives to encourage cocoa production. It was laudable that the Ghanaian authorities had recognized the need for a coordinated, consistent development strategy to provide a distinct sense of direction for the medium-term objectives. More would need to be done to sustain the progress already made, and hence the involvement of the World Bank, working in close cooperation with the Fund, was welcome. Of particular importance was the assistance to be provided by the Fund and the Bank for the preparation of the medium-term plan for resource mobilization and allocation. Concrete results were needed as early as possible in that area.

Mr. Clark remarked that the current program remained well on track. It was encouraging to see that Ghana had become the first country to secure funds under the World Bank's Special Facility for Sub-Saharan Africa. The authorities should be commended for having again taken additional measures to compensate for a possible revenue shortfall and for having overfulfilled by a considerable margin the performance criteria on external arrears.

Although substantial progress had been made, some difficult years remained ahead, Mr. Clark cautioned. It was taking time to restore the productive base and infrastructure of the economy, for example, to rebuild the transport system and to restore the cocoa plantations. The adjustment policies should be maintained through the next several years. Moreover, the staff and the authorities were wisely designing a medium-term development strategy with the assistance of the Bank. Ghana was an excellent example of a country where the development strategy needed the support of appropriate macroeconomic measures and where conversely the success of the macroeconomic measures would depend on the restoration of the economy's supply capacity. Accordingly, the closest Bank-Fund cooperation would be essential.

Ghana would need to increase capital expenditures in the future, Mr. Clark noted. The authorities had prudently instituted fiscal measures that concentrated on improving public savings and planned to strengthen the revenue base. Domestic savings had risen to their highest level in five years. Nevertheless, at just over 5 percent of GDP, they still remained relatively low compared with other African countries having similar per capita incomes. To reduce its dependence on external capital flows, Ghana needed to increase both public and private savings. Rapid achievement of positive real interest rates would provide an incentive for increased private savings, but a restoration of confidence in the system would also be necessary, and that would be a longer process.

Unfortunately, the staff report had indicated that the extent of neglect of the cocoa sector seemed to have been underestimated, and the current producer price appeared insufficient to induce large-scale replanting and to eliminate smuggling, Mr. Clark concluded. The long gestation period of replanted trees and the fact that cocoa accounted for two thirds of total exports, called for immediate remedial action to ensure favorable medium-term prospects for the sector. Would the Fund and World Bank staff representatives comment on what further adjustment of prices, including the exchange rate, might be needed and what other nonprice measures might be considered?

Mr. Coumbis considered that the Ghanaian authorities had continued to adjust their economy successfully in 1985, as they had done in 1984, and were attaining their major program objectives. Additional progress would be achieved through the continued increase in the consumer price of cocoa and the elimination of price controls, as well as the continued devaluation of the cedi, which would contribute to the profitability of export industries.

The authorities had taken appropriate actions to offset revenue shortfalls from import, excise, and cocoa export duties, Mr. Coumbis advised. They had also correctly increased government expenditures to rehabilitate the infrastructure, especially road transportation and railways; by financing those expenditures through capital inflows, the target for the overall deficit of the public sector had been met.

Although the growth of liquidity was cause for concern, it seemed to have been absorbed by a shift in the demand for money, which indicated an increase in public confidence, Mr. Coumbis observed. To obtain positive real interest rates would represent further progress.

Even with the revised medium-term scenario for the balance of payments, Ghana could still perform satisfactorily by the end of the decade, provided that the authorities obtained the required financial assistance and provided that they maintained their rigorous adjustment efforts, Mr. Coumbis considered. Special efforts would be needed to diversify exports and to increase the production of cocoa; appropriate pricing strategies could help achieve those goals. To further assure success, the construction of a consistent medium-term plan for resource mobilization and allocation, with the cooperation of the World Bank, should be given special priority. The authorities had already requested technical assistance from the World Bank in order to prepare the plan. Would the staff comment on whether the medium-term plan would be ready for the Consultation Group meeting in November?

Mr. Rye stated that Ghana's adjustment was progressing as programmed. The Government's budget deficit had fallen from 4.5 percent of GDP in 1982 to less than 2 percent of GDP in 1984. The banking system had thus been able to finance other productive sectors in the economy, and increased the absorption of external resources as domestic counterpart funds became available. Although still short of projections, official long and mediumterm capital disbursements had risen by 40 percent in 1984. Over the two years to end-1984, external arrears had been reduced by more than half. The authorities were moving rapidly toward regaining control over monetary aggregates.

Especially noteworthy among Ghana's recent achievements was the vigor with which the authorities had effected improvements on the supply side even as they had borne down rigorously on demand management, Mr. Rye continued. Agricultural productivity had responded well to increases in producer prices. Infrastructure rehabilitation had picked up, with most beneficial effects on certain sectors of the economy, such as manganese, bauxite, and manufacturing. A growth rate of 5.3 percent in real GDP was a realistic projection for 1985. Inflation had decelerated in the past year, with the consumer price index having risen by less than 40 percent, compared with 123 percent in 1983. For the first time since 1983, moreover, the ratios of domestic investment and savings to GDP had improved. Over the past two years, substantial depreciation of the cedi and the dismantling of price controls and consumer subsidies had resulted in a shift in relative prices in favor of exports and efficient import substitution.

Despite these accomplishments, the need for discipline had not diminished, Mr. Rye cautioned. The year 1985 continued to afford no room for slippages and, indeed, it posed the additional challenges of debt management, given the high debt service pressures that Ghana would be experiencing in the years ahead; the need to hasten the recovery of exports other than cocoa in order to reduce the country's dependence on that single crop; and the requirement for additional measures to recoup an estimated ₵ 3.3 billion shortfall from originally projected revenue, due to declines in cocoa export duties, in import duties, and in excise duty collections.

The program for 1985 remained rigorous, and appropriately so, Mr. Rye went on. While the planned increase in the overall government budget deficit to 2.3 percent of GDP in 1985 from 1.8 percent in 1984 reflected an expected absorption of noninflationary concessional external finance, the authorities should be careful not to let the rise be misconstrued as a signal of a more relaxed fiscal stance. It was reassuring that the bank finance component of the budget had been programmed to decline as a ratio to GDP. The reorganization of the civil service structure and procedures was an additional sign of the authorities' determination to exercise effective control over the fiscal sector. It would be useful to learn more about the authorities' plans for Ghana and the World Bank's role in the reform of the public enterprises.

Monetary and credit policies appeared to be broadly on target, Mr. Rye considered. Broad money had exceeded its targets at end-December 1984 and at end-March 1985; did the actual figures for end-June 1985 show a continuation of that trend, or had the trend been arrested? The flexibility with which the authorities had approached interest rates, including the most recent increases, was commendable. Nonetheless, the authorities might still be too conservative in moving deposit rates toward real levels.

The Ghanaian authorities had wisely begun to design, with World Bank and Fund assistance, a medium-term strategy for development, Mr. Rye added. Continuation of international support would depend, for the present, on Ghana's ability to maintain its close adherence to its adjustment program and, for the medium term, on its formulation of a comprehensive strategy consistent with the availability of resources. Ghana would need international development support throughout the medium term.

Ms. Lundsager remarked that the second review of Ghana's stand-by arrangement indicated that the program was continuing with a firmly entrenched record of adjustment. The targeted rate of growth of over 5 percent still appeared feasible, due in large part to increased agricultural production following depreciation of the currency, producer price increases, and good weather. Furthermore, the manufacturing sector was also showing rapid recovery, following increases in imports financed with external concessional assistance. Ghana's adjustment program represented a good example of the flexibility of the Fund--an increase in the fiscal and current account deficits had been possible in 1985, mainly because external financing was expected to cover the deficits. At the same time, the inclusion of a substantially increased investment budget indicated that growth and development objectives could mesh with financial adjustment.

A strong adjustment effort should be maintained because of the still difficult medium-term outlook, as reflected in Table 6 of the staff report, Ms. Lundsager emphasized; in fact, the authorities should accelerate their efforts if possible. Residual financing gaps were still expected for several years ahead, and the success of filling those gaps hinged largely on the authorities' pragmatic implementation of structural and macroeconomic adjustments.

Particularly noteworthy was the authorities' continued willingness to adjust the exchange rate and producer prices, Ms. Lundsager added. Ghana's example demonstrated to other countries the forceful impact that currency realignments could have on the traded goods sector. The dramatic drop in inflation that had occurred during the same time that the currency had depreciated substantially had indicated that increased supply could have a much stronger impact on domestic inflation than had the currency depreciation. It appeared that additional adjustments would be required to ensure a return to a viable balance of payments and particularly to restore fully the financial viability of the cocoa sector, in order to stimulate increased plantings of trees, and the commitment of the authorities to pursue that policy was welcome.

The fiscal outcome for the year would remain broadly in line with expectations, Ms. Lundsager continued. The Ghanaian authorities merited commendation for having readjusted expenditures in the face of some revenue shortfalls, in order to sustain their development expenditures. Ghana's response demonstrated what countries could do themselves to protect their development budget.

Recalling the inadequacies of the civil service wage structure, Ms. Lundsager urged the authorities to continue to improve the structure and efficiency of their civil service by means of selective wage increases. The emphasis being placed on the redeployment of labor toward the productive sector, as described in Mr. Salehkhou's buff, was encouraging.

Ceilings on net credit to the Government had aided the attainment of the fiscal targets, while credit to the rest of the economy had increased substantially over its low level in 1984, Ms. Lundsager noted with pleasure. Periodic adjustments in interest rates were apparently improving the position of commercial banks, and it would be helpful if the staff could give an estimate of the domestic savings rate in 1985.

Mr. Wijnholds declared that a tremendous adjustment effort had finally reversed a decade-long deterioration in the Ghanaian economy. The authorities' drastic change in domestic policies had been at the heart of the success, and credit from the Fund--almost SDR 600 million--had played an essential role in "jump starting" the economy. In fact, between 1982 and 1985, the Fund had evolved as one of the main creditors of Ghana. Nevertheless, Ghana's recovery had reached an important turning point. While continued recovery and rehabilitation seemed to be within reach if the present policy stance could be maintained, considerable additional financing--on the order of $300 million net a year for the next three years--would be essential. Given the already large amounts provided by the Fund, as well as the fact that Ghana was a low-income country and needed concessional financing in particular, other creditors, and preferably donors, would have to be involved to an increasing degree. Since a well-defined, medium-term development strategy would be a condition sine qua non for success in that effort, the authorities should complete their formulation of that strategy as soon as possible. The World Bank would continue to play a major role, and reflows from the Trust Fund could also assist Ghana.

The staff's medium-term scenario had implied that if Ghana's balance of payments gaps were to be financed by further credits, the ratio of total external public debt to GDP would rise further to around 60 percent, in the period to 1990, Mr. Wijnholds added. Such a development would make it all the more important to realize the envisaged underlying economic improvement. Several indications gave rise to doubt about the adequacy of Ghana's exchange rate. Imports were effectively competing with local supplies, with retail prices of the latter having dropped below the officially proposed prices; was such competition desirable, given Ghana's difficult balance of payments situation? The problem of cocoa smuggling remained; the staff had recommended tackling it by means of an increase in producer prices and further devaluations, although such action, unless very rigorous, might further depress the parallel exchange rate and thereby maintain the profitability of smuggling. Finally, the authorities needed to give further support to the profitability of exports other than cocoa.

Mr. Abdallah noted that in 1985, the Ghanaian economy was expected to repeat its good performance of 1984, while inflation was expected to subside steadily, thanks to the authorities' successful implementation of strong adjustment measures that had been supported by the Fund. Under the current program, Ghana had met all the quantitative performance criteria; the remainder of the program was also likely to be successful, as the authorities had shown that they were willing to take additional measures as demanded by changing circumstances.

While the economy continued to move broadly in the right direction, there were many areas in which some further improvement was required, Mr. Abdallah remarked. The authorities should persevere in their efforts, since Ghana's medium-term prospects indicated that imbalances would persist. For example, heavy debt service payments would remain a dominant feature until the end of the decade. The authorities should start evolving a strategy that would enhance the servicing of Ghana's external debt, including repurchases to the Fund, without placing undue constraints on future growth. The present situation provided an excellent opportunity to do so because the momentum for adjustment was already strong, and external confidence--a necessary ingredient for the much-needed external financial support--was also rising. It would be important to attract an appropriate mix of external finance that would not exacerbate the already critical debt situation. The scenario presented in the staff report, which showed that additional financing would entail a debt service ratio that could rise to as much as 50 percent of current earnings during 1986-88, gave rise to apprehension. Given that the final balance of payments outcome was sensitive to the availability of development assistance, commodity prices, and international interest rates, the authorities were well advised to stand ready to take additional measures if one or more of the underlying assumptions should fail to materialize.

By promptly developing a medium-term investment program, the authorities could allay donors' uncertainty surrounding the key assumption relating to development assistance, which would need to be granted on highly concessional terms, Mr. Abdallah suggested. However, part of the problem stemmed from inadequacies in project preparation and implementation. Confidence would also be increased if fiscal action, including expenditure-saving and revenue-raising measures, could be carefully followed up to prevent slippages. If the authorities felt the need to enhance their competence in implementing or monitoring the fiscal measures, they should consider calling upon the World Bank and the Fund for technical assistance.

Mr. Suraisry indicated that since 1983 the authorities had made strenuous efforts to correct deep-seated problems that had characterized the economy of Ghana for some time. Far-reaching measures had been taken on both the demand management and supply sides, so that the economy of Ghana was well placed to benefit from improvements in the world economy and from increased foreign financing. Ghana had indeed benefited from the restructuring and stabilization policies undertaken so far, but the authorities would need to continue those policies to achieve lasting success. The need for pursuing such a strategy would extend beyond the current program, scheduled to expire at the end of 1985. Further increases in producer prices would still be required to encourage domestic production, particularly in agriculture. The infrastructure was still inadequate to permit full advantage to be taken of the improvements in domestic output; export diversification was required to reduce dependence on cocoa; and international confidence in the economy still needed to be restored.

He welcomed the authorities' commitment to a cautious fiscal policy, as reflected in the 1985 budget, Mr. Suraisry remarked. The budget projected a small increase in the overall fiscal deficit to help rehabilitate infrastructure, which seemed to be justified. He also welcomed the flexibility that was reflected in advocating an increase in the deficit, but he agreed with Mr. Rye that that should not lead to a relaxation in fiscal policy.

In that context, the loss in total revenue ensuing from a less favorable balance of payments had complicated the authorities' task, Mr. Suraisry said, however, like the authorities, he believed that development expenditures should not be adjusted downward as a result. As Ghana was in the midst of restructuring and reorienting its economy, it would not be good planning to cut investment programs when domestic output had responded favorably to such programs. He fully supported the plan to cover the shortfall in revenue, mostly through additional revenue measures.

Although they had made progress during the first half of 1985 in reducing inflation to 20 percent, the Ghanaian authorities should monitor the faster than anticipated growth in broad money so as to avoid any slippages in achieving monetary targets, Mr. Suraisry noted.

The authorities had continued their commitment to a flexible exchange policy, Mr. Suraisry commented, even in the face of a downward revision of export earnings. They should support that policy with appropriate measures geared to improving productivity in the export sector, reducing inflation, achieving a more realistic pricing strategy, liberalizing the exchange rate system, and overcoming transportation bottlenecks. The authorities' progress in those areas was evident from the growing external assistance in support of their efforts. Firm and sustained adjustment efforts would continue to be needed to assure Ghana of adequate external assistance.

The authorities had made a good beginning in reducing Ghana's external payments arrears, Mr. Suraisry said. Elimination of all arrears would be essential if Ghana was to acquire the substantial foreign financing it would need over the medium term. Therefore, the authorities should manage the external debt cautiously; their room for maneuver was very limited, and the performance criterion that limited the contracting and guaranteeing of nonconcessional foreign loans was vitally important.

The Ghanaian authorities had made commendable efforts to correct the weaknesses in their economy, Mr. Suraisry concluded. Ghana was a perfect illustration of the responsiveness of the international community when a country showed its resolve to tackle its economic problems seriously and consistently.

Mr. de Groote commented that developments in Ghana were most satisfactory, as evidenced not only by an 8 percent increase in GDP, but also in comparison with other countries in the area. African countries in particular had reason to be grateful to Ghana for having demonstrated that pessimistic generalizations were not valid, provided that appropriate policy measures were taken. It was true that Ghana had been helped by an especially favorable crop, but the essential ingredient in Ghana's recent success had been the adoption of correct measures, notably a flexible exchange rate policy and a reduction of the public sector deficit.

The projected increase in government outlays to fulfill rehabilitation objectives was to be financed largely by local savings and foreign funds, Mr. de Groote noted with satisfaction. Development expenditures would be doubled, and Ghana typified the case of a country that was adjusting its public finances to specific structural needs, a process that surely would be recognized by the World Bank. Ghana would continue to need considerable financial assistance in the future, and for much longer than had been envisaged initially. One of the interesting features of Ghana's situation was the adoption of an investment code that was more liberal than those in most countries in similar circumstances; the code made attractive provisions for exchange earners who could open an external account in which 25 percent of their earnings might be retained for investment, debt servicing, and transfers of dividends and profits. Thus, Ghana was likely to attract private funds to add to the external financial resources available through debt rescheduling and the official development assistance to which it was entitled as a low-income country.

He was not concerned about Ghana's future exchange rate policies, Mr. de Groote said. The letter from the Ghanaian authorities gave no reason to doubt that they would not continue to follow a flexible exchange rate policy. The results of their actions to date had been so obviously successful that the authorities would surely be wise enough to continue following that course. Exchange rate adjustments should be made with care and judgment with respect to their timing and dimension.

The staff representative from the African Department said that the staff and the Ghanaian authorities agreed with the Executive Directors that Ghana could not afford to be complacent. Moreover, a great deal of work was under way to prepare a medium-term plan in time for presentation to the Consultative Group meeting. A fiscal review mission was already in Ghana and would be addressing questions of resource mobilization as well as the question of tax administration. Such missions were an example of the close cooperation between the Fund and the Bank; a Bank staff member was participating in the Fund fiscal review mission and a Fund staff member had participated in a Bank expenditure review mission earlier in the year.

The provisional figures for the end of June 1985 indicated that the growth rate of the money supply had continued to exceed the target slightly--32 percent rather than 31 percent--but both figures were lower than the projected GDP growth rate, the staff representative went on. It was not uncommon for the rate of growth of the money supply to show seasonal fluctuations; it tended to be higher in the first part of the year when the cocoa crop was being purchased. The present situation was not a cause for alarm, but it did merit careful monitoring.

The fact that the fiscal deficit had increased in 1985 compared with 1984 should not be seen as a sign of relaxation, the staff representative stated. As the World Bank expenditure review mission had pointed out, certain expenditures would have to be increased; notably, there was the question of appropriate remuneration to the Ghanaian civil servants. The authorities were moving away from across-the-board salary increases toward increases that rewarded merit and effort, linked furthermore to an effort to reduce the size of the civil service. Increased efforts would also be necessary to rationalize spending on education and health. Increases in public expenditures would have to be matched by increases in resource mobilization; financing from the banking system must continue to be reduced.

It was likely that interest rates would soon be positive in real terms, the staff representative indicated. As the confidence factor increased, continuous increases in domestic savings could be expected, both for public and private savings.

The important question of the exchange rate could not be separated from the need for further increases in producer prices, the staff representative remarked. The Ghanaian authorities did indeed remain committed to a flexible exchange rate policy; any differences of view that might arise would relate to the speed with which the exchange rate moved. As the staff report had indicated, the time had perhaps come for some acceleration in the rate of adjustment, which would only be possible within the context of a balanced package that included such factors as producer prices. Since producer prices for cocoa were traditionally changed in advance of a crop season, no increases would occur before the spring of 1986, but it was expected that for the cocoa crop year 1986/87, the producer price would be adjusted upward in time to provide a sufficient incentive for new planting. The current producer price was probably adequate for maintenance, but it was not yet sufficient to provide incentives for increased planting. Moreover, it was not sufficiently remunerative to eliminate smuggling.

With regard to the public enterprises, the World Bank had recently received a draft of the final report prepared by its consultants, the staff representative from the African Department stated.

The staff representative from the World Bank added that the World Bank staff had been discussing public enterprises for some time with the Government of Ghana. As a result of those discussions, consultants had been appointed to study some 100 state-owned enterprises, and they had recently submitted their report, which was a set of comprehensive data on the sector, including considerable detail on 13 of the most important public enterprises. The World Bank would be discussing the report with the authorities in the middle of October 1985. It was hoped that a program of reform would subsequently be designed, including the divestment of certain public enterprises in the context of later adjustment programs.

Mr. Salehkhou observed that Ghana had come a long way since the Board had discussed its request for a stand-by arrangement. Much of the progress could be attributed to the authorities' commitment and discipline. Nonetheless, one key factor that could help assure continued success in their adjustment effort was concessional financing, not just for Ghana but for other African countries. For example, administrative reforms in the public sector were essential; at the same time, the morale of civil servants had to be sustained. Wage levels were low, and some wage increases were in order. Furthermore, many development projects merited funding. However, deficit financing was a dubious solution: he recalled that the reduction of high rates of inflation had been no easy task. Ghana needed concessional flows and external financing to maintain its successful adjustment effort.

The Chairman made the following summing up:

> Executive Directors noted with considerable satisfaction the significant recovery of economic activity and income, and the sharp deceleration of inflation in Ghana since early 1984. They concurred with the staff's view that these developments reflected, in addition to the impact of more favorable climatic conditions, the economy's response to the supply and demand management policies pursued resolutely and successfully by the

Ghanaian authorities with Fund support since early 1983. Directors were encouraged by the quickening in the pace of rehabilitation of the infrastructure in line with the acceleration in disbursements of external assistance and by the positive impact this had had on exports. They were, however, disappointed by the slower than expected recovery of cocoa production in Ghana over the 1984/85 crop year and by the necessity to revise downward earlier projections on cocoa production for the medium term.

In this context, they stressed the continued need for providing appropriate price incentives, requiring the pursuit of a flexible exchange rate policy to encourage cocoa production through new planting, and to promote production and investment in other traditional and nontraditional export sectors.

Directors commended the authorities for having adhered to the targets of their 1984/85 program, particularly with a view to the necessary further depreciation of the cedi, the adjustment of interest rates toward positive real rates, and the elimination of price controls. They stressed that the authorities' strict adherence to the objective of containing the fiscal deficit in 1985 to a level consistent with a decline in domestic bank financing had greatly contributed to the successful stabilization of the economy, while freeing financial resources for the rest of the economy without reigniting inflationary pressures. The larger than programmed reduction in external arrears was noted with satisfaction.

Directors welcomed the authorities' decision to correct a projected shortfall in 1985 budget receipts by the timely adoption of new revenue measures and implementation of expenditure savings in the area of current outlays, but emphasized the need to strengthen public savings through further comprehensive revenue mobilization. They supported the authorities' desire to maintain development expenditures at the programmed level in view of the urgent rehabilitation needs of the infrastructure. Further action would also be needed to improve the accounting and the financial position of state enterprises.

Directors expressed concern at the difficult balance of payments situation that Ghana would be likely to face from 1986 to 1988. They felt, however, that the attainment of a viable balance of payments situation remained possible before the end of the decade, provided that the thrust of the adjustment effort undertaken since 1983 could be maintained, particularly in the area of exchange rate policy, to promote further the shift of relative prices in favor of productive export and efficient import substitution activities, and to strengthen investors' confidence. Directors were encouraged by the Ghanaian authorities' intention to adopt a comprehensive three-year plan for resource mobilization and allocation for the period 1986-88. They welcomed the increased involvement of the World Bank in Ghana and urged continued close collaboration between the Fund and the Bank on Ghana.

Directors urged the donor community to enhance its support of Ghana's economic program by increasing its concessional assistance to the country. The country, indeed, had begun to show very tangible signs of success in the handling of its economic problems. They stressed that donor support remained a critical element in Ghana's effort to maintain a viable medium-term balance of payments position without sacrificing the objective of rebuilding the economy and maintaining a sustainable rate of real economic growth.

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

The Executive Directors then adopted the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Ghana's exchange measures subject to Article VIII, Section 2, and in concluding the 1985 Article XIV consultation with Ghana in the light of the 1985 Article IV consultation with Ghana conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The restrictions on payments and transfers for current international transactions, as described in EBS/85/211 and in SM/85/252, are maintained by Ghana in accordance with Article XIV except that the exchange restrictions evidenced by external payments arrears and the restrictions on transfers of balances under the bilateral payments arrangements with Fund members are subject to approval under Article VIII, Section 2. The Fund notes the intention of the authorities to remove these exchange restrictions as soon as possible and grants approval for the retention of the exchange restrictions that are evidenced by external payments arrears, until August 31, 1986 or the completion of the 1986 Article IV consultation with Ghana, whichever is the earlier. The Fund urges Ghana to terminate the remaining bilateral payments arrangements with Fund members as soon as possible.

Decision No. 8080-(85/141), adopted
September 13, 1985

Review Under Stand-By Arrangement

1. Ghana has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Ghana (EBS/84/172, Sup. 4, 8/29/84) and paragraph 31 of the letter of intent signed by the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984, attached to the stand-by arrangement, as supplemented and modified by their communication of November 28, 1984 and the letter of April 26, 1985.

2. The letter dated August 27, 1985 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana shall be annexed to the stand-by arrangement for Ghana, and the letter dated July 30, 1984 shall be read as supplemented and modified by the communication of November 28, 1984, the letter of April 26, 1985, and the letter of August 27, 1985.

3. The Fund finds that no further understandings are necessary, and that Ghana may proceed to make purchases under the stand-by arrangement.

Decision No. 8081-(85/141), adopted
September 13, 1985

## 4. USE OF RESOURCES OF SPECIAL DISBURSEMENT ACCOUNT ARISING FROM TERMINATION OF TRUST FUND - PRELIMINARY CONSIDERATIONS

The Executive Directors considered a staff paper on preliminary considerations relating to the use of resources of the Special Disbursement Account arising from the termination of the Trust Fund (EBS/85/183, 8/6/85, and Cor. 1, 8/8/85).

Mr. Mtei made the following statement:

Our discussion of the use of the resources of the Special Disbursement Account today is of particular importance to many low-income developing countries in view of the exceptional economic and financial difficulties they have generally been facing. The indicators in Table 1 of the staff report provide a summary of the hardship which many of the low-income developing countries are encountering. In particular, the group of countries labeled by the staff as "less creditworthy, very low-income countries"--many of which are in Africa--have experienced a persistent decline in per capita income and a sharp deterioration in terms of trade over the past decade or so. Their current account deficit doubled in the last few years and their reserve/import ratio declined sharply despite continued compression of imports. Mark you these are only averages; in some individual cases conditions have been worse.

Debt rescheduling arrangements in respect of this category of countries have provided temporary relief. Nevertheless, the debt/GDP and debt service ratios stood at 50 percent and 36 percent, respectively, in 1984. According to staff assessment, prospects for recovery in these countries are not encouraging. The global recovery is expected to have only a minimal effect on their economies and, "given the depth of their current difficulties, will leave them in circumstances that are still extremely difficult." With diminished access to capital markets, declining official inflows, mounting external debt, and no significant growth in exports, little progress can be expected to take place, while social and political costs associated with adjustment have been extremely high.

Over a number of years, many of these countries have been putting much effort to adjustment. However, it has become clear that in view of the structural nature of the prevailing imbalances and the severe domestic resource constraint, such adjustment could take place only gradually and over an extended period of time and could be successful only if supported by substantial inflows of resources. Under the prevailing circumstances, it is not likely that the inflow of resources to these countries, whether from private or official sources, would increase in any meaningful way.

These circumstances indicate the need for doubling efforts to increase availability of external financing substantially. The link between these fundamental considerations with the use of the resources of the Special Disbursement Account is clear. The contribution that the facility we are discussing today can make in alleviating the problem, not only by providing resources but also as a catalyst to attract more financing from other sources, cannot be overestimated. It is my belief that the prevailing economic and financial circumstances should have important bearings on the form, eligibility, conditionality, and terms for the assistance to be provided by the reflow of resources resulting from the termination of the Trust Fund.

In contrast with the time of the Trust Fund establishment, circumstances facing low-income developing countries today reflect wide variation in their experience. While many low-income developing countries have done relatively well in terms of growth and financial stability since 1977, the group of "less creditworthy, very low-income" countries have experienced further aggravation in their economic and financial difficulties. Even a strong global recovery is not expected to result in a significant improvement in their economies. I have already alluded to this exceptionally difficult situation in the first part of my statement. I am stressing these differences in experience because I consider them to be of fundamental importance when considering the modalities of the arrangement for the use of the resources of the new facility.

I want to stress that I fully share the staff view that there is need to limit the use of the resources of the Special Disbursement Account to those countries with the greatest need of concessional assistance and least access to alternative sources of finance. It is not only their very low per capita incomes that should be considered but also the dire straits in which they find themselves, in many instances because of circumstances beyond their control. There are obvious reasons why access to the new facility should be guided by these considerations. The resources available from the reflows from the Trust Fund are relatively small (accruing at the rate of only SDR 535 million a year) and would thus provide meaningful assistance if their use is limited to the countries in greatest need, with limited or no access to private capital markets. Official flows to these countries have declined both because of the fiscal situation in donor countries and diversion of a substantial portion of bilateral flows to higher-income countries in view of the reduction of private lending to the latter countries. Financial assistance from the Fund to the very low-income, less creditworthy countries has also been on the decline for the several reasons mentioned by the staff.

For these reasons, I agree with the staff that while the level of per capita income should be the first criterion for eligibility, there is need, when it comes to actual disbursement, to limit eligibility among the low-income countries to those with greatest need for concessional financing, no access to private markets, and which have continued to face persistent external and internal imbalances over a prolonged period of time. This way, it would be possible to have an impact on the use of the resources of the new facility. In principle, I have no difficulty with a provision to be made to allow access for countries in emergency circumstances. However, I feel that further qualifications regarding type of emergency, level of income, and access to and availability of other sources should be important factors in allowing access to these resources.

It may also be desirable to question the staff proposal to use all resources made available by the termination of the Trust Fund under a single arrangement. I believe that the second type of possible arrangement mentioned in the 1980 decision was meant to be more liberal. My reading of the second sentence of Article V, Section 12(f)(ii), which governs the use of resources available under the second type of arrangement, is that it does not exclude the possibility of providing assistance in a grant form to low-income countries in exceptionally difficult circumstances. In fact, I would strongly propose that the remaining resources could, with advantage, be used to assist member countries which are not recalcitrant and are cooperating with the Fund but are facing genuine difficulties to meet their financial obligations to the Fund. Such assistance could be provided in a grant form or concessional long-term loan with, say, ten years' grace period and ten years' repayment period. In this way, these resources could be used to create conditions to make countries in difficult circumstances able to meet their obligations to the Fund and thus normalize their relations with the international financial community, and help an early resumption of flow of assistance from donors and creditors. Another option could be to use half of the "remainder" in grant form and the other half as an addition to the amount to be used on the same terms as the Trust Fund loans.

Turning now to the modalities for the first type of arrangement, I agree that while allocation of available resources may be reviewed with changes in prevailing circumstances, it is important that qualifying members be assured of commitment of funds for a period of several years at the time that a member qualifies. Actual disbursement of funds could be made annually on the basis of an economic program presented by the member in a credible letter of intent. This appears to be necessary to provide the needed assurance to adjusting members that their efforts will have continued financial support over a number of years.

I note that the staff proposes to use members' quotas as a criterion in determining maximum access. However, it should be noted that the same countries with relatively small quotas are the ones which are in greatest need of concessional assistance. Therefore, it is important that the extent of members' needs and the special circumstances of individual countries be taken into consideration beside quota levels when setting a figure on maximum access. Otherwise, countries in greatest need could be deprived of the assistance because of the low level of their quotas if their genuine need is not given due attention.

The need to ensure that adjustment is taking place is well recognized. However, I would like to stress here a number of points. The structual nature of the imbalances and the depth and duration of the economic problems experienced by these countries, particularly in sub-Saharan Africa, limit the speed at which progress in adjustment can be achieved and therefore would require a longer framework than normally envisaged under Fund programs. Because the economies of these countries have already been trapped by the low level of demand as a result of continued austerity measures over extended periods, additional demand management conditionality of the type attached to Fund programs would be counterproductive. What is needed is structural adjustment programs developed within medium- and long-term framework stressing growth element through rehabilitation of existing production capacity and its expansion. I do not therefore support the staff proposal of linking disbursement to prequantified performance criteria or semiannual reviews. In my view, this will make the use of these resources highly conditional, something that is not consistent with the spirit of the Trust Fund.

As was the case under the Trust Fund, first credit tranche conditionality should be sufficient to make a loan under the arrangement receivable. An eligible member should qualify by showing that it is making a reasonable effort to strengthen its balance of payments position. I have already mentioned that disbursement should be made annually on the basis of an annual economic program contained in a letter of intent and a general assessment of progress made in the preceding year in view of program objectives, taking into consideration the particular circumstances of the individual country concerned.

In welcoming cooperation between the Bank and the Fund in helping members to design economic programs capable of addressing structural problems, and to ensure availability of adequate financing, I should hasten to caution that such collaboration should not become another form of conditionality. It should not be necessary that in order to qualify under the new facility, a country should have a structural adjustment loan from the World Bank.

I should also stress here that funds from the Special Disbursement Account should be in addition to resources available from other sources, such as IDA or the Sub-Saharan African Special Facility as well as from the Fund's regular resources, and should not be viewed as a substitute. I am particularly concerned by the staff statement on page 18 in the third paragraph regarding the so-called prolonged users of Fund resources. Does this mean that a member's right to use Fund resources would be, in effect, suspended because it has continued to use Fund resources for a number of years even if it is meeting all its obligations under the Article of Agreement? To what extent is this consistent with rights of membership and the principle of equal treatment of members? This chair has always cautioned against overemphasizing the revolving character of Fund resources and the staff statement I referred to is one of the results of this undue emphasis.

Mr. Dallara made the following statement:

I welcome this opportunity to consider the future use of the resources that will become available from Trust Fund reflows. The staff paper is most helpful in that it provides constructive ideas and lays useful groundwork for our discussion. While today's discussion is, of course, preliminary, we believe that it can provide a significant contribution to, and a basis for, the discussion our Ministers will have on this topic in Seoul.

Reflows to the Trust Fund are beginning at a particularly significant time for this institution and for certain of its members. It is a time when some members--still beset by a range of economic problems--have used significant amounts of Fund resources over an extended period of time, calling into question the monetary character of this institution. Their continued economic problems suggest that much is yet required in terms of policy change and in strengthening the economies and balance of payments of such members. If such adjustment efforts are required, continued financial support for the efforts will also be required. But we must find a way to provide this support that does not compromise the revolving character of Fund resources, for we firmly believe that if that is compromised, in the long run the institution and those very members we are trying to assist will be hurt.

The Trust Fund reflows present us with a unique opportunity to resolve, at least in part, this difficult dilemma. As Secretary Baker pointed out during the G-10 Ministerial meeting in Tokyo, the United States believes that an important opportunity exists to use Fund resources stemming from the Trust Fund reflows in collaboration with the World Bank, in a coordinated response to the very serious economic and balance of payments problems of low-income developing countries.

As we have developed our thinking on the Trust Fund, we were influenced in part by the significant amount of progress that has been achieved during the last few years on the very serious balance of payments and debt problems of many developing countries, particularly many of the larger debtors. While serious problems remain, and continued, persistent efforts by these countries, along with the international community, will be required, we do at least have positive momentum on which to build.

Progress for some countries, on the other hand, and here I speak primarily about many of the very low-income countries, has not been as significant. While important progress has been achieved in some specific areas, many problems still exist in these countries, as evidenced by their low growth, limited balance of payments adjustment, and increased debt service requirements. Several of these countries have borrowed extensively from the Fund under a number of successive programs, and the economic results have not been what was hoped for. Further, recent external events, including drought, have increased the need for external financial assistance on concessional terms for many of these countries, as Mr. Mtei points out in his buff statement, and made it more difficult to achieve a clearly sustainable balance of payments position in a short time frame, even with the essential element of sound policies. In addition, budgetary constraints in many of the industrial countries have limited concessional bilateral aid flows.

These circumstances, including inappropriate policies, economic difficulties, and limited sources of finance, have led to an increased incidence of "prolonged use" of Fund resources, and in some cases to the development of arrears to the Fund, calling into question the strength of this institution and its ability to respond to the needs of its members. An approach that would use the Trust Fund resources to provide concessional financing to very low-income members with serious balance of payments problems, many of which are in Sub-Sahara Africa, in support of broad economic programs would be a positive and possibly crucial step forward in addressing the serious problems of these countries and the Fund.

I would like to outline for you our proposed approach to the use of Trust Fund reflows which we believe would most effectively accomplish the objectives I have outlined.

First, with respect to the important issue of eligibility, the staff paper points toward an approach that would, in effect, limit eligibility to those countries that are, by the World Bank's definition, "IDA-only" countries or, in other words, countries that can use solely IDA funds and no IBRD funds. We believe this is a sound approach that would direct the resources to those countries most in need.

However, we recognize this approach could pose some difficulties for certain members. We have given thought, therefore, to another approach to eligibility that would permit a broader array of countries to be eligible. This approach would also involve, separate from the issue of eligibility, criteria for use and access that would alleviate the need to set aside funds for countries that are eligible, but not likely to meet other criteria for actual usage during any particular year. Let me make clear, however, that our willingness to support this particular approach to eligibility will be dependent on others embracing all aspects of it.

As was the case under the original Trust Fund, basic eligibility could be based on income level alone. A per capita income of, perhaps, less than $550--as suggested in the staff paper--might be appropriate. The $550 per capita income would, by definition, include "very low-income countries."

Actual use of the facility, among those who might be eligible, could be based on an eligible country meeting both of the following criteria:

1. The existence of a protracted balance of payments problem. I have come to appropriate just how difficult it is to define exactly what a "protracted balance of payments problem" is, but I do not think it is useful for the Board to spend a great deal of time trying to resolve this definitional issue today. I might add that while it is difficult to define, it is not so difficult to recognize.

2. A willingness to adopt a comprehensive economic program to promote structural adjustment and growth, reflecting both the important problems and objectives of these countries.

A third factor that could be given some consideration in determining if an eligible country would actually use the funds could be the degree of access to private credit markets. I would not suggest that this be a criteria per se, but rather something taken into account.

Access of individual members to the Trust Fund would be determined on the basis of Fund quotas. For purposes of determining a country's relative quota share, annual judgments could be made by staff, perhaps approved by the Board, as to which members would be likely to meet the criteria for use that I have just described, during the initial 12-month period and for each subsequent 12-month period. A list of such members would only be indicative and for planning purposes and would not preclude any eligible member from approaching the Fund for use of these resources. (Actual use would, of course, depend on an eligible country's ability to meet the special criteria for use of the funds.)

We envisage terms that involve interest rates and grace and repayment periods similar to those of the earlier Trust Fund.

That brings me to the content of the economic programs we believe these resources should support. As I said in my introductory remarks, we believe that economic programs should be designed to promote structural adjustment, and, very importantly, also to promote growth. The need to develop broadly designed programs and to make them successful for the countries using the resources, suggests the need for very close cooperation between the Fund and the Bank. In fact, we believe that programs should be developed and negotiated jointly by the Fund, the Bank, and the member. Although some may consider this a bold step, we believe that this could provide a very effective means of addressing problems faced by many of these countries. Jointly negotiated programs, of course, should also be accompanied by funds from the World Bank, to move in parallel with Trust Fund reflows.

To continue with the specifics of such programs, we have in mind the following particular elements:

- The member would commit to a two-year macroeconomic and structural economic program.

- A Joint Fund/Bank team would negotiate with a member each program, and ideally prepare a single document for consideration and approval by both the Fund and Bank Executive Boards. If this were to be the case, it would be important that consideration by the two Boards occur at roughly the same time, or certainly within a short consecutive time frame, in order that the member not be disadvantaged by bureaucratic and institutional difficulties. While there may be some legal issues to work out, we would assume that each Board would legally approve the resources under its particular jurisdiction.

- We do not suggest that release of funds be subject to performance criteria per se, but we do believe that release of funds should be associated with the use of quantitative targets, as well as qualitative objectives, both of which could be used in the context of semiannual reviews. Our thinking has been that quantified targets would be evaluated in a flexible and qualitative way, bringing a judgmental approach to bear in evaluating progress on the program.

- We would expect a program to cover areas such as fiscal policy, money and credit policies, relative prices, and exchange rate policies. The program should also cover structural elements that have been increasingly covered in Fund programs, but where the World Bank has particular expertise, such as investment policies, trade liberalization, and marketing arrangements. We believe this combination of flexibility in conditionality and breadth of policies could provide an important benefit to the individual countries using these resources. This broad range of policy measures should also permit the economic effects of individual policy steps to be magnified and, therefore, of greater benefit to the member.

- Each two-year program would include semiannual drawings, with the first drawing to be associated with approval of the program and the remaining three drawings to be associated with satisfactory completion of each semiannual review.

- Assuming satisfactory performance under the original program, eligible members that meet criteria for use could, of course, apply for follow-on two-year programs.

That concludes the basic outline of the approach to the use of the future Trust Fund reflows that we would hope Directors and their Ministers, and management, could consider. Let me reemphasize that our ideas have been conceived with a view toward focusing Trust Fund reflows, joined by World Bank resources, on the very low-income countries experiencing protracted payments problems. We believe that the opportunity must not be lost to lay the basis for members that have fallen into difficult situations, but are prepared to work their way out of such situations, to do so in an orderly manner. The most effective and efficient way to accomplish this, in our view, involves the approach I have outlined.

We recognize that this approach involves some important issues, and some ambitious aspects, and will require considerable reflection. We hope that all of you will reflect on our suggested approach with open minds and in a spirit that is receptive to the need to consider an innovative approach if we seriously wish to help our members resolve the difficult problems they face.

Mr. Alfidja asked what practical differences--aside from any legal aspects--Mr. Dallara saw between collaboration by the World Bank and the Fund in the form of a joint team to negotiate a program and the existing separate procedures of the two institutions for negotiating structural adjustment loans and extended arrangements, respectively.

Mr. Dallara responded that a number of the elements of the approach he had outlined, particularly those relating to policy, were covered already under extended arrangements with the Fund and structural adjustment loans with the Bank. The important distinction that he would draw rested on the need to support a member in a fashion that was not only coordinated in substance but coordinated in time so that the interaction of policies could have the best opportunity to promote growth. The World Bank and the Fund had strengthened their efforts and made major policy moves to improve their collaboration and cooperation; but even more could be done to give members a better idea of the full range of policies that could be designed not only to promote balance of payments adjustment but to promote development and growth first at a given point in time and subsequently over a longer period of time. Despite what had been accomplished under the current practices and policies of the Fund and Bank, the assistance provided by the two institutions to members could be increased if the programs of low-income developing countries could be supported not only by Trust Fund reflows but by World Bank resources.

The Secretary of the Treasury had taken a personal interest in the approach that he had outlined in his opening statement, Mr. Dallara noted. Therefore, he would report to him with great care the comments of those Directors who spoke for the countries that would benefit from the common effort being made to provide them with additional support.

The Chairman asked whether Mr. Dallara in fact envisaged a joint operation in which funds from the Trust Fund and the World Bank would be merged.

Mr. Dallara confirmed the Chairman's understanding. He recognized that such an approach might arouse fears of administrative difficulties, not arising in any way from shortcomings on the part of either the World Bank or the Fund but from the mere fact of bringing the two institutions closer together. Differences in the practices of the World Bank and the Fund with respect to the length of time taken to prepare programs and documentation and in the nature of the discussions in the two Boards might not be easy to reconcile. He also recognized that Directors might see irreconcilable problems in reaching an accommodation with members under such a broad policy approach, including the risk that the member itself might be subjected to tighter conditionality. His authorities did not take that view: if low-income developing countries were to have any prospect of a much better situation by, say, 1990, his authorities saw no alternative to the approach they were proposing, especially if the two institutions had sufficient will to utilize their clear capacity to accomplish the objective sought.

Mr. Sengupta raised the procedural point of how the Executive Board would be able to discuss the use of the resources of the Special Disbursement Account at exactly the same time as the World Bank was to discuss the provision of a loan.

Mr. Nimatallah observed that the primary requirement for use of the Fund's resources in support of a program was that the member have a balance of payments need. For the World Bank to agree on a structural adjustment loan, the country must have a need to carry out structural adjustment in the medium term. The two institutions were attempting to reconcile those two different requirements in supporting members' programs. A technical question that had occurred to him was whether Mr. Dallara was proposing a different kind of criterion for utilizing the reflows to the Trust Fund based on a definition of a longer-term balance of payments need.

Mr. Dallara commented that balance of payments need would continue to be a basic requirement for use of Trust Fund reflows. The existence of a protracted balance of payments problem would be an important criterion although it would of course be difficult to define. It was nevertheless obvious that the difficulties of low-income developing countries were not on the whole short term, and he foresaw no particular problem in reconciling the criteria for use of Trust Fund reflows with use of other resources of the Fund and the World Bank.

The Chairman remarked that countries with difficult and protracted balance of payments problems frequently came to the Fund for assistance. If the Fund had some assurance that the member's balance of payments position would become viable over the medium term, it was able to provide such assistance under its existing policies. At the same time, appropriate macroeconomic and exchange rate policies often had to be supported by structural adjustment policies in order to attain the productive and growth-oriented development that was essential from the point of view of both the Fund and the World Bank.

Mr. Sengupta commented that Mr. Dallara might have in mind two programs that were simultaneously conceived: a Fund-supported medium-term adjustment program that bordered on structural adjustment, and a structural adjustment program supported by the World Bank. Greater collaboration between the two institutions would be helpful. However, the proposal to send a joint team of Bank and Fund staff members to consider a country's problems and needs, and to devise a program that could be supported by Trust Fund reflows and as yet unidentified World Bank resources, was a new approach and would call for an understanding between the two institutions. The Fund should not commit itself to support such a new approach before it had considered whether it would be appropriate to use Trust Fund reflows to finance joint programs, and whether the World Bank would be able to provide additional resources.

Mr. Zhang observed that it was very difficult to know to what extent a country's problems were due to long-term structural difficulties or to medium-term difficulties.

Mr. Dallara said that it was the impossibility of separating the structural from the macroeconomic in many of the complex situations of certain low-income developing countries that called for a more integrated approach by the Fund and the Bank. Procedurally, the proposals he had made might be new but they went in the direction in which the two institutions had been moving, toward increasingly close and effective collaboration.

Mr. Nimatallah asked whether Mr. Dallara could give further thought to the possibility of having two parallel programs rather than a joint program in case the latter raised legal difficulties.

Mr. Dallara responded that many questions would have to be considered before the approach he had outlined could be implemented, despite the considerable effort that had gone into its delineation.

The Director of the Exchange and Trade Relations Department said that he agreed with Mr. Dallara that his proposals would raise many questions needing a systematic response. It was vital to seek the views of the World Bank, which might have difficulty in determining the amount and terms of the assistance it could provide. The magnitude of the Trust Fund reflows would be set largely by the availability of funds. The substantive issue posed by Mr. Dallara's proposal concerned the precise nature of the association between the two institutions. Either the World Bank and the Fund would not support a member's program unless they were satisfied about all the aspects that were critical to them both, or each institution would move in accordance with its own judgment, but based on an understanding of parallel action by the other institution. For example, the Fund might have to decide whether to support a program in the absence of the infrastructural environment that might be needed to make the program work.

Mr. Dallara remarked that his authorities did not view their approach as involving difficult issues of cross conditionality or negotiation between the two institutions. The idea was to have one team, one program, and one set of negotiations, with a view to providing the member with a more clearly understandable, integrated set of policies. The program would be formulated by the staff of the two institutions working closely together with the member. No longer would the Fund have to proceed to support a program, based on one set of considerations, while the World Bank proceeded on another, different plan of action, requiring the two institutions to grapple constantly with the difficult problem of deciding which linkages between the two programs mattered.

The Director of the Exchange and Trade Relations Department remarked that his initial response had been given in broad terms, in the sense that the Executive Directors of the two institutions would have to resolve certain issues separately.

The Director of the Legal Department said that it would be easier to deal with the institutional and legal issues that might arise when more was known about the approach outlined by Mr. Dallara.

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

## DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/140 (9/12/85) and EBM/85/141 (9/13/85).

### 5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/235 (9/11/85) is approved.

APPROVED: May 23, 1986

LEO VAN HOUTVEN
Secretary