NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/72

10:00 a.m., May 7, 1984

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
J. de Groote	
B. de Maulde	X. Blandin
	M. Teijeiro
	M. K. Bush
	S. R. Abiad, Temporary
	T. Yamashita
J. E. Ismael	
R. K. Joyce	
A. Kafka	
	G. Grosche
	N. Coumbis
R. N. Malhotra	
	E. M. Ainley, Temporary
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
	E. Portas, Temporary
	A. K. Juusela, Temporary
	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
L. C. Collier, Assistant

Also Present

B. Legarda, Consultant. African Department: J. B. Zulu, Director; N. Abu-zobaa, E. L. Bornemann, J.-C. K. Brou, E. A. Calamitsis, R. O. Carstens, M. E. Edo, J. W. Kratz, P. D. Mortimer-Lee, M. C. Niebling, B. R. H. S. Rajcoomar, M. Sidibé, R. T. Stillson, E. Williams, U. Wilson. Exchange and Trade Relations Department: S. Kanesa-Thasan. IMF Institute: R. Basanroi, E. Djokpe, K. Gozan, Participants. Legal Department: G. P. Nicoletopoulos, Director; J. M. Ogoola, J. V. Surr. Advisors to Executive Directors: C. J. Batliwalla, L. K. Doe, L. Ionescu, H.-S. Lee, Y. Okubo, D. I. S. Shaw. Assistants to Executive Directors: J. R. N. Almeida, J. Bulloch, M. B. Chatah, M. Eran, G. Ercel, D. Hammann, N. U. Haque, T. Ramtoolah, J. Reddy, A. A. Scholten, Shao Z., Wang C. Y., M. A. Weitz, J. C. Williams.

1. MAURITIUS - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on a review under the 15-month stand-by arrangement for Mauritius (EBS/84/77, 4/4/84; and Sup. 1, 5/3/84).

Mr. Alfidja made the following statement:

In 1983, as in previous years, developments in the Mauritian economy continued to be dominated by the activity in the sugar industry. Sugar production, which had hardly recovered from successive years of adverse weather, was 12 percent lower than that of 1982. The drought, partly responsible for the decline of the sugar output, also had an unfavorable impact, together with the December 1983 cyclone, on the nonsugar sector.

As a result of the slowdown in activity just described, a large number of workers were forced out of jobs and thus contributed to exacerbating the unemployment problems facing Mauritius. Estimated at a rate of 20 percent of the labor force in 1983, unemployment remains a source of concern to my Mauritian authorities. In contrast, inflation has continued a sustained decline over the last five years. Despite a considerable relaxation of price controls in 1983 the rate of inflation dropped below 10 percent reflecting declines in import prices as well as the moderation in wage increases.

The cost of living wage adjustment was only 6.5 percent in fiscal year 1982/83, compared with 13.6 percent in the previous period, and the annual increase in earnings averaged a little more than 9 percent, half of the rate of increase during fiscal year 1981/82.

During the first half of the year, budgetary revenue was about 6 percent below the target, while budgetary expenditure was 7 percent below the target. Total revenue for the year is projected to be about 3 percent below the budget forecasts, owing mainly to shortfalls in import duties and the land development tax. To achieve the planned reduction of the budgetary deficit, the authorities decided to further reduce the growth of expenditure, saving notably on the wage bill and capital expenditure, and further improving monitoring of expenditure. As a result, budgetary expenditure for the year is projected to be 4 percent below the initial forecasts and the revised budgetary deficit is now projected at about 8.3 percent of GDP, a reduction of 1.5 percentage points from the 1982/83 level.

Reflecting the lower budgetary deficit and a higher nonbank financing of the budget, the expansion of domestic credit as well as the growth of money supply are likely to remain below program levels for the entire fiscal year. The removal of ceilings on lending interest rates in early 1983, led, as expected, to higher real rates. However, at the end of 1983 it became evident to the authorities that the high levels of real interest rates constituted a serious obstacle to the legitimate demands for credit to finance productive activities of private sector investment. Therefore, the authorities took steps to keep interest rates at more appropriate levels, including a reduction of the central bank's rediscount rate and of the treasury bill rate.

In the external sector, the current account deficit was reduced to a level below the program's target on account of a slight fall in imports. However, due to lower disbursements of concessional loans, the overall balance of payments is projected to record a slight deficit instead of the previously projected surplus. As pointed out by the staff, Fund credit will contribute to the financing of this deficit and allow an increase in the level of official reserves to the equivalent of five weeks' imports at the end of the fiscal year. As far as the exchange rate is concerned, the Government has continued to follow a flexible policy after unlinking the rupee from the SDR and pegging it to a basket of currencies representative of Mauritius's trade pattern.

I share the staff's view that the 1983/84 adjustment program is basically on track. All quantitative performance criteria for end-October and end-December 1983 were observed. However, the authorities consider that the imbalances in the economy are still substantial, particularly in the public sector. The Government is committed to a further significant reduction in the overall fiscal deficit and in bank financing of the 1984/85 budget. To this end, the authorities will examine measures to widen the tax base rather than increase the existing tax rates and to further reduce expenditures, in particular capital transfers to the public enterprises. The authorities have undertaken some institutional changes to improve tax administration. Wage policy in the public sector will be subordinated to budgetary constraints while, in the private sector, it will be guided by Mauritius's competitiveness and employment productivity. The Government expects the average wage increase to be less than the inflation rate. The Government is contemplating switching from the present system of minimum wage awards to one of decentralized wage negotiations in the private sector. The authorities will also continue their present flexible exchange rate policy with a view to improving the competitiveness of the economy.

The medium-term prospects over the period 1984/85 to 1988/89, although based on conservative assumptions, as acknowledged by the staff, are moderately encouraging. Sugar exports are projected to rise by an average 5 percent a year and exports of manufactured goods are projected to rise by 12 percent. The current account deficit is projected to average 4 percent of GDP during the period, with the ratio falling below 4 percent starting in 1986/87.

The Government intends to take steps aimed at improving the financial conditions of the sugar industry, including a tax relief package and a revision of the consumer price of sugar. The Government has considered the report of the Commission of Inquiry which was established in 1983 to study the industry and make recommendations for its long-term viability. The Government is now preparing a comprehensive plan to stabilize the industry's costs of production, to restore its profitability, and to rationalize its operations.

The performance of Mauritius under successive Fund programs has been very good, and significant progress has been achieved in reducing the external and internal imbalances. My Mauritian authorities are committed to implementing all measures set forth under the current program, and they are prepared to take all additional measures as may be needed. They hope that the financial assistance from friendly countries and from international institutions, including the Fund, will continue to be provided to support the country's adjustment effort.

Mr. Malhotra stated that he agreed with the staff appraisal and supported the proposed decision. Mauritius had continued to make commendable adjustment efforts and the current review showed that its track record remained excellent. The current program, which had a strong structural adjustment content that aimed at stimulating growth, exports, and investment, should enable the authorities to lay the foundation for gradually overcoming the serious long-term structural constraints facing the economy.

The review of the present arrangement and the further commitments given in the letter of intent of March 1, 1984 confirmed that Mauritius remained a well-managed and efficiently run economy, Mr. Malhotra continued. Despite adverse developments, the authorities had demonstrated a strong commitment to correcting their internal and external imbalances. They had met all the performance criteria under the current stand-by arrangement, and although, for reasons beyond their control, they had been unable to meet the growth target, they had faithfully fulfilled the undertakings given in their letter of intent. As noted at the seminar on small tropical island countries (Seminar 84/4, 5/4/84), it was extremely difficult for small open economies to adjust quickly. Nevertheless, the progress achieved in the fiscal, price, and external trade areas had been gratifying. Inflation had been brought down below 10 percent. The authorities had made a determined effort to contain the fiscal deficit. Although as a percentage of GDP the deficit was still 8.5 percent, the authorities remained committed to a further reduction both in the overall deficit and in bank financing of the budget in 1984/85. To that end, the authorities had recognized the need to hold down current and capital expenditures. On the revenue side, the decisions to set up a Unified Revenue Board and a tax tribunal should help to strengthen the institutional framework for improved tax collection and administration. The program for restructuring the parastatal enterprises in collaboration with the World Bank was also a step in the right direction.

With regard to foreign trade, even in the face of protectionist pressures, the authorities had progressively liberalized imports and had agreed to move from import licensing to imports regulated mainly through appropriately structured tariffs by end-1984, Mr. Malhotra commented. At the same time, the authorities had fulfilled the commitment to implement flexible exchange and interest rate policies. Several measures were already in place that would lay a sound base for exports of manufactures. The staff's medium-term projections showed that an average growth rate for exports of over 9 percent a year in volume terms could be achieved in the period 1983/84 to 1988/89, provided that protectionist policies against Mauritian exports were not intensified. The unfavorable prospects for sugar exports and associated supply-side constraints reinforced the need for expanding exports of other manufactures and increasing receipts from tourism in order to overcome the high level of unemployment that continued to be a disturbing aspect of the Mauritian economy and that could add to the difficulties of structural adjustment. The move to link wage settlements in the public sector to productivity changes was welcome. The delay in initiating the decentralized wage bargaining process was understandable; the authorities were correct in first creating an appropriate institutional framework and a propitious climate before launching the experiment.

Looking to the future, it was evident that in devising financial and structural adjustment policies, the Mauritian authorities should bear in mind the external and climatic conditions that had impinged on the development of the economy in the past and could recur in the future, Mr. Malhotra said. The medium-term scenario presented in the staff report indicated that the external position of Mauritius would remain vulnerable in the years ahead, and the country would continue to need concessionary finance. Its adjustment strategy should evoke the confidence of the international community so that needed resources on concessional terms would be forthcoming. Mauritius's close collaboration with the World Bank in seeking advice and development finance to restructure its investments should prove helpful.

Mauritius would have to watch very carefully its debt profile, which had tended to deteriorate in the recent past, Mr. Malhotra remarked. Since exports were subject to wide fluctuations and foreign exchange reserves were low, there was little leeway for further commercial borrowing. The debt service ratio was expected to peak at 29.2 percent in 1984/85 and thereafter was expected to decrease only gradually to 20.1 percent in 1990/91, under optimistic assumptions. He was therefore encouraged that the authorities had shown considerable prudence in limiting new nonconcessionary borrowing. In the past, Mauritius had drawn extensively on its foreign exchange reserves, but for a very open economy subject to large fluctuations, a higher level of reserves was necessary.

Mauritius had maintained a good record of adjustment to date, Mr. Malhotra remarked; it had heeded advice and had remained ready to implement additional adjustment measures when needed to achieve balance of payments viability over the medium term. Despite the prolonged use of Fund resources, Mauritius remained a creditworthy and deserving candidate for further Fund assistance.

Ms. Bush noted that Mauritius had continued to make progress in reducing external and internal imbalances since the previous review in November of its performance under the current stand-by arrangement. She was in broad agreement with the staff appraisal and supported the revised proposed decision. The policy stance of the authorities appeared to be appropriate in the present circumstances of Mauritius. Consequently, the 1983/84 program was basically on track, with both the fiscal and balance of payments targets likely to be met. In particular, she welcomed the authorities' commitment to take whatever additional measures were necessary to ensure that the financing gap indentified for 1984/85 would be closed.

Regarding fiscal policy, in spite of the modest improvement over the original program target in 1983/84, the overall fiscal deficit was still too high, Ms. Bush commented. She therefore welcomed the authorities' commitment to a further reduction in the overall fiscal deficit and their aim of achieving a surplus on government current operations in the next fiscal year. Fiscal policies would be particularly challenging, given the effects on government revenues of measures to provide relief to the sugar industry. Fund technical assistance should continue to be provided in the fiscal area.

Credit and monetary policies had been appropriate, although Ms. Bush noted that the authorities intended to move to a more flexible method for achieving their credit objectives. Interest rates should continue to be managed flexibly during the upcoming period, when inflationary pressures were expected to intensify, so as to maintain positive real interest rates.

The authorities were to be commended for their continued pursuit of a flexible exchange rate policy, Ms. Bush continued. That was a key policy tool to enhance Mauritius's competitiveness, thereby addressing one of the Government's major policy objectives--job creation to alleviate the persistently high unemployment. Her chair noted with regret the effect of increasing protectionism on Mauritius's growth prospects, particularly since that protectionism deprived the Mauritian economy of the full benefits of the difficult policies that the authorities had pursued.

She welcomed the inclusion in the staff paper of the section on measures to improve the finances of the sugar industry, Ms. Bush said. She agreed with the authorities' view that recent actions were only the first steps in improving the outlook for that sector. The authorities' work on a package of supporting structural measures for the sugar industry in collaboration with the World Bank was laudable.

With regard to the role of the World Bank in Mauritius, Ms. Bush recalled that in December 1983 the World Bank Executive Board had approved a second structural adjustment loan for $40 million. That loan was designed to support programs for export-led industrialization, tourist development, and agricultural diversification; measures to promote employment; and policies to improve public resource management. In view of the clear need for structural adjustment over the medium term, that World Bank credit was appropriate. As other Directors had suggested in previous Board discussions, she would welcome in future staff papers a more comprehensive presentation on World Bank activities and objectives in Mauritius.

Mr. Prowse said that he agreed with the staff appraisal of the program for Mauritius's relatively successful island economy. That success had been recorded despite the adverse effects of protectionism, especially agricultural protectionism, in its markets.

The budget deficit was higher than could be sustained over the medium to long term, Mr. Prowse observed, as was the current account deficit. Those were the benchmarks to be considered in determining the amount of concessionary and grant assistance that was available to a country like Mauritius. Special factors in the Mauritian economy were at work to moderate the effect of those deficits, which might be unacceptable elsewhere. The staff had noted that the improvement in the external account had been due mainly to a compression of imports, and he wondered whether the real activity of the economy was being affected significantly.

There was a need to build up reserves and to increase concessionary aid, Mr. Prowse continued. The external debt was not overwhelming but remained an important issue for policy management. He supported the staff assessment and the Fund's continuing relationship with Mauritius. With regard to the design of the program, he wondered how precisely unemployment had been factored. What priority did the reduction of unemployment receive compared with the reduction of inflation or the budget deficit? Because unemployment had increased to its highest level--20 percent--he wondered whether some other objectives ought to have been modified in order to recognize the increased difficulty in the employment sector.

Mr. Ainley stated that he endorsed the staff appraisal and supported the proposed decision, as revised. The Mauritian authorities had made commendable progress in recent years in stabilizing their economy with the support of the Fund. Performance under the present stand-by arrangement had been impressive in many respects. All the performance criteria had been met; the fiscal and external deficits had been reduced as planned; and inflation had been brought under control. Equally encouraging, a number of important measures had been taken to improve domestic resource allocation and to make the economy more competitive. However, difficult problems remained. Growth had been disappointingly weak; unemployment had risen to about 20 percent of the labor force; the sugar industry continued to face financial problems; and the budget deficit remained at a high level in relation to GDP.

The authorities recognized the problems and were making determined efforts to correct them, Mr. Ainley remarked. He welcomed, in particular, their plans to restructure the sugar industry, which still accounted for a very large proportion of exports. That was a critically important task, and he was pleased that the World Bank was providing technical assistance in that area. He also welcomed the measures taken to diversify the economy; those measures had already had some success in promoting tourism and manufactured exports. But diversification would only succeed if the country had access to international markets, and Mauritius would benefit considerably from a lowering of protectionist barriers by its main trading partners.

He supported the firm stance of domestic financial policies, Mr. Ainley said. The authorities' continued commitment to wage restraint was commendable; it was essential for the strengthening of competitiveness and the improvement of employment prospects in the private sector. The intention to link future wage increases more closely to productivity gains was welcome.

On the fiscal side, Mr. Ainley continued, the new system of monitoring and controlling public expenditure had worked well and should be continued. Government expenditure should be directed to productive uses so as to stimulate growth, output, and national income. On the revenue side, the authorities should press ahead with plans to strengthen tax administration and collection procedures. He also hoped that they would explore ways of broadening the tax base in the budget for 1984/85. It would, of course, be important that any new revenue measures should not discourage savings and investment by the private sector.

With regard to monetary policy, the authorities had been successful in reducing bank financing of the budget deficit, Mr. Ainley commented. There should be scope, within the agreed credit ceiling, for channeling more credit to productive activities in the private sector. As the authorities recognized, the present methods of monetary control had proved cumbersome and had led to rigidities. He therefore welcomed their intentions to introduce more flexible methods in the future.

Externally, the balance of payments had clearly benefited from the adoption of a flexible exchange rate strategy, Mr. Ainley remarked. Mauritius seemed well placed to attract sufficient long-term capital to finance the projected current account deficit in 1984/85. The authorities' commitment to take further adjustment measures if those were necessary to improve the medium-term prospects for the balance of payments was commendable.

In short, Mr. Ainley concluded, the authorities were making comprehensive adjustment efforts on both the demand and supply sides. But there were limits to what Mauritius could achieve by its own efforts. The authorities needed the support of donors, trading partners, and the international financial community.

Mr. Salehkhou commented that the overall performance of the economy in the past few months had been mixed, with progress having been recorded mainly in the financial sector. The budgetary position remained viable with revenues slightly exceeding the target. The sales tax and stamp duties had been increased, and reductions in nontax revenues reflected lower external grants. At the same time, total expenditures had also been lower with capital expenditures showing a larger fall than current outlays. As a result of cost-saving measures, the budget deficit for 1983/84 would be less than the original program target.

There had also been substantial improvement in containing inflation, Mr. Salehkhou continued. Owing to a moderation in import prices and wage increases, the rate of inflation would be less than the program's target despite the removal in late 1983 of maximum price ceilings for many important items.

Monetary developments had also been under close control with lower than projected credit expansion, mainly reflecting a smaller fiscal deficit, Mr. Salehkhou observed. Nevertheless, there was a need for greater flexibility in the implementation of monetary policy, especially because of the private sector's need for additional funds. He welcomed the intention of the authorities to accord greater flexibility to the monetary policy stance. He invited further comment on the indirect method of credit control favored by the Government; would those measures include changes in the credit ceilings on individual banks?

In the external sector, Mr. Salehkhou continued, the current account deficit would be less than the original program target, as a result of a fall in both exports and imports. The fall in imports was due to a decline in import prices that would help to improve the terms of trade for 1983/84. Sugar exports, accounting for the bulk of total export earnings, would be less than projected, mainly due to the protracted drought in 1983. Exports had been affected by both the adverse weather conditions and increasing protectionism in industrial countries. While little could be done about the weather, there was clearly much that could be done by many countries to increase access by Mauritius to their markets. It was equally disappointing to note that concessionary capital disbursements would be lower than previously expected. That reduction was apparently due to delays in project implementation, and he invited the staff to comment on the main reasons for such delays.

Because the sugar industry formed the backbone of the economy, Mr. Salehkhou said that he welcomed the decision of the authorities to reform the sugar export duty formula to ease the tax burden, raise domestic prices, eliminate the brokerage fee, and provide other incentives for exporters. In view of the somber medium-term outlook for sugar exports for the next five years, did the staff believe that the reform measures were sufficient to restore profitability in the sugar industry? What were the views of the World Bank team on that important issue?

In the real sector of the economy, developments had not been satisfactory, Mr. Salehkhou commented. Economic growth in 1983/84 would be less than the program target, mainly due to drought, the cyclone that had affected nonsugar agricultural production, and the mediocre performance of the sugar industry. As a result, unemployment was high and was a major concern to the authorities. He hoped that greater emphasis of manufacturing and agriculture could bring about further diversification of the economy. It was encouraging that the flexible exchange rate policy adopted by the Government had helped to strengthen the tourism and manufacturing sectors. The measures taken in March 1984 to adjust some important commodity prices were equally important. He asked what element of subsidy was included in the prices of items such as rice, sugar, and wheat flour, and what was likely to be the financial impact of those measures, announced in March 1984, on the budget.

It was clear that in the face of exogenous obstacles, the economy of Mauritius was in need of continuous and persistent adjustment, Mr. Salehkhou concluded. In that spirit, he welcomed the intention of the Government, as mentioned in the letter of the Minister of Finance, to seek another stand-by arrangement with the Fund after the completion of the current arrangement. To conclude, he supported the proposed decision.

Mr. Camara said that he was in broad agreement with the staff report. Despite the bad weather experienced by Mauritius in 1983--a drought followed by a cyclone--the adjustment efforts had been continued by the authorities. He commended their willingness to cooperate with the Fund in seeking solutions to their economic problems. Because economic activity in 1983/84 had been adversely affected by poor weather conditions, real GDP was expected to show only a modest increase compared with the previous year. Unemployment also remained a problem. However, the authorities had continued to make progress on the fiscal front. The budget deficit was projected to be the equivalent of 8.3 percent of GDP in 1983/84, compared with 14 percent three years previously. That reflected mainly the efforts that had been made to control expenditures, and to some degree the steps taken to improve revenue collection.

He welcomed the undertaking that the authorities had made to reduce the deficit further in 1984/85, Mr. Camara continued, because it remained high despite the decline over the years. Measures under consideration to widen the tax base and to reduce outlays to certain parastatal corporations, if successfull, would help the authorities to contain the growth of credit expansion and the money supply. That action was necessary in the fight against inflation, where remarkable improvement had been seen over the years. The steps being taken to liberalize the economy, exemplified by the lifting of price controls for a wide range of commodities, and by progressively reducing restrictions on imports, were commendable. With regard to the reduction of import restrictions, it was important to keep in mind the foreign exchange restraint that often stood in the way of good intentions.

The medium-term scenario for Mauritius's balance of payments was encouraging, Mr. Camara remarked, although debt service, including repurchases to the Fund, was likely to create some strain. The staff had projected an expansion in exports in the next few years, but caution would be necessary in the wake of growing protectionism in some of Mauritius's trading partners. To fill the financing gaps that were likely to emerge, the authorities should make an effort to attract concessionary inflows to avoid further aggravating the debt burden.

Mr. Joyce stated that he was in general agreement with the staff appraisal. Adjustment measures had been implemented vigorously by the authorities in Mauritius, and progress was being made despite often adverse circumstances at home and abroad. Indeed, in some respects the authorities had done better under the program for 1983/84 than originally envisaged, most notably with regard to deficits on government operations and on the current account of the balance of payments. It appeared that Mauritius would complete the program under the stand-by arrangement successfully. He congratulated the authorities for pursuing a more flexible exchange rate policy and a determined monetary policy stance.

Nevertheless, Mr. Joyce continued, there were some worrying aspects about the medium-term prospects despite the progress registered. Growth to date was still disappointing; unemployment remained unacceptably high at 20 percent; and Mauritius continued to face serious and growing barriers to its exports. Those were matters not completely under the control of the authorities and they had made the path of adjustment more difficult. He welcomed the efforts by the authorities to restructure and develop key sectors of the economy: tourism, manufacturing, and, in particular, the sugar industry.

There were three areas that would be important for the success of the adjustment effort in the medium term, Mr. Joyce stated. First, the authorities had made significant progress in reducing the overall fiscal deficit. Nevertheless, the revised figure for 1983/84--8.3 percent of GDP--while better than programmed, was still high, and the authorities would have to implement further fiscal measures in 1984/85 if that deficit were to be brought down. Measures proposed to broaden the tax base and to contain capital outlays for inclusion in the 1984/85 budget were welcome. Those measures, however, might not be sufficient if they must also offset the loss of revenue arising from the tax relief envisaged for the sugar industry. There might be further scope for more vigorously controlling current government expenditures than in previous years, and hence generating positive central government savings.

Adjustment under the previous three programs had focused primarily on reducing capital outlays, while current expenditures had remained at approximately 25 percent of GDP, Mr. Joyce recalled. Admittedly, there had been some improvement in that respect in the past year. While he recognized that improving the efficiency of the investment program had been an important objective, the authorities could not go too far in cutting back on investment, and they should now concentrate on reducing current expenditures. He welcomed the authorities' intention to achieve a better balance in the current fiscal account in the coming fiscal year.

Second, structural imbalances, including extensive price controls and wage rigidities, remained in the economy, Mr. Joyce remarked. While he commended the authorities for removing one third of the items subject to maximum prices from controls and for increasing utility rates, the removal of the remaining price controls and the elimination of subsidies on rice and wheat flour could be important if not crucial in stimulating production and correcting the fiscal imbalance.

With regard to wages, Mr. Joyce continued, he welcomed the move of the authorities toward a system of direct wage negotiations and their commitment to keeping wage increases in the public sector below the projected rate of inflation. While he recognized the problems associated with an abrupt shift to decentralized bargaining, an early move toward linking pay changes more closely to productivity gains in the public sector could lead the way to reducing wage rigidities in both the public and private sectors.

Third, the detailed analysis of the medium-term outlook for the balance of payments contained in the staff report was extremely helpful, Mr. Joyce considered. But it was clear from Table 9 that continued strong adjustment and additional concessional resources would be needed in the future. The overall balance of payments was projected to be in surplus in 1985/86 and 1986/87, but the estimates excluded repurchases from the Fund and did not allow for the projected buildup of reserves of approximately one and one-half months of imports. When those were taken into account there was a substantial financing gap in both years. It was important not only to repay the Fund but also to build up reserves because, inter alia, there was no guarantee that the external current and capital accounts would perform as well as anticipated.

A more worrying aspect was that Fund repurchases accounted for 43 percent of total debt service in both 1984/85 and 1985/86, Mr. Joyce remarked. A substantial increase in concessional flows would be necessary if the authorities were to be in a position to make repurchases from the Fund during that period. He was not saying that the Fund, therefore, should not provide further assistance to Mauritius. On the contrary, the significant adjustment efforts the authorities had already made and continued to make deserved further Fund support. But that support could only be envisaged if it was accompanied by some assurance of significant nonproject aid, from both multilateral and bilateral agencies, for the medium term. It was only through a balanced program of assistance, which in the case of Mauritius must inevitably be concessional, that that small country could maintain its growth while having the means to service its indebtedness to the Fund and other creditors.

Mr. de Maulde remarked that he welcomed the review of the stand-by arrangement for Mauritius, especially as the staff report provided clear evidence that there had been marked improvements in two areas where, at the time of the previous discussion, he had expressed some doubts regarding the appropriateness of the policies being followed by the Mauritian authorities.

First, in the sugar industry, measures had been taken to restore the financial situation of producers, which had deteriorated heavily, Mr. de Maulde observed. Nevertheless, the sugar export duty, whose elimination had been advocated by the Chairman of the Commission of Inquiry, remained at the high average rate of 20 percent. It was a sensitive question that triggered controversy in Mauritius. Sugar played a crucial role in the economy and in exports, and a healthy financial situation in that sector was a prerequisite to sufficient levels of investment and therefore for future production and exports. The World Bank was reviewing that problem and a satisfactory solution would be a condition for the release of the second tranche of the structural adjustment loan, which was forecast to take place in November 1984. He was confident that the World Bank and the Mauritian Government would devise a sensible program, and he looked forward to a progress report at the time of the Board's next review.

Second, Mr. de Maulde noted with satisfaction that interest rates had been lowered, a welcome development, as rates had been at such high levels that they had constituted a heavy burden for the productive sectors and, among others, for the sugar industry. Deposit and lending rates, however, remained high in real terms; he invited the staff to comment on the appropriateness of the present levels.

On the external sector, Mr. de Maulde remarked that there was some question in his mind as to whether the medium-term balance of payments projections in the report had not erred on the conservative side, at least with regard to nontraditional exports. There seemed to have been a sudden surge of interest in investment in the export processing zone, encompassing both new investments and expansion of existing industries. Was it true that demand was such that all available sites had been utilized and that new sites would have to be provided? If so, the prospects for nonsugar exports might be brighter than forecast in the report.

The financing gaps would not be eliminated in the near future, Mr. de Maulde considered. The Fund was experiencing some difficulty in playing its "catalytic role" since commercial banks did not seem anxious to extend the $38 million Eurocurrency loan mentioned in Table 9. If that loan did not materialize, and in view of the magnitude of the financing requirements for 1984/85 and 1985/86, the Fund would obviously have to play a financing role and enter, in future years, into new arrangements backed by continued support and financing from the World Bank.

The staff representative from the African Department explained that the involvement of the World Bank would be treated more comprehensively in the forthcoming Article IV consultation discussions with Mauritius.

The compression of imports in 1983/84 mainly reflected a reduction in capital imports, as a result of the streamlining of the public sector investment program that had been revised with World Bank technical assistance, the staff representative said. There had also been a sharp reduction in the growth of consumer imports brought about by existing monetary policy; specifically, installment credit by commercial banks had not been increased for the past three or four years. There had been no indication of any compression in imports of raw materials to the manufacturing sector.

With regard to the priority given in the stand-by arrangement to the reduction of unemployment, the staff representative continued, it had been hoped that the improvements in resource allocation, and the pursuit of the flexible exchange rate policy, would have helped the manufacturing sector and reversed the decline in employment that had taken place in both sectors. Demand difficulties on the world market and the tight monetary policy had both slowed the potential resurgence in the manufacturing sector. There was evidence that employment in the manufacturing sector had begun to increase, and the staff anticipated that it would continue in 1984. In the sugar sector, the difficulties in 1983/84 had resulted in a greater than anticipated fall in employment, but the staff believed that the recent measures taken to help the sugar industry would bring that decline to a halt.

Credit expansion by the commercial banks was controlled through a system of direct ceilings based on a formula that took into consideration the growth in deposits and the credit needs of the sugar sector, the staff representative explained. While it had worked reasonably well, it had created rigidities and in early 1984 banks had refused to take deposits. At present, the staff anticipated that the shift in monetary policy would involve a more active use of liquidity ratios in controlling private sector credit expansion.

Part of the shortfall in capital inflows in 1983/84 was attributable to delays in the formulation of investment projects, the staff representative said. Specifically, there had been a delay in finalizing arrangements for a significant loan from the the African Development Bank, and the disbursements from the World Bank structural adjustment loan had been slower than anticipated. As to the adequacy of the measures taken in the sugar industry, both the staff and the authorities envisaged them as first steps in a more fundamental restructuring plan. The measures would enable the more efficient companies to increase investment levels that had fallen significantly in recent years. The Mauritian authorities were discussing with the World Bank a package of supporting structural measures that was expected to be put into operation in the second half of 1984. The Mauritian authorities had also stated that if more direct financial relief was necessary they would be prepared to consider it, subject to the constraints of the public finances.

Recent price increases would reduce the subsidy on rice and wheat flour from about one third of the market price to about 20 percent and 25 percent, respectively, the staff representative remarked. In terms of the effect on the budget, the authorities should be able to restrict their subsidy bill to just over $100 million, as anticipated in the program.

As for the measures taken to correct the problems of the sugar industry, the staff representative continued, the Chairman of the Commission of Inquiry had recommended the elimination of the export tax over a period of years. The Commission had, in fact, issued two reports containing, in some cases, widely differing recommendations. The authorities had been discussing with the World Bank and the Fund a package of measures that would take into account the views of the Commission.

On current levels of interest rates, the staff representative from the African Department stated that the deposit rate structure was positive in real terms, with the current rate on savings deposits at 8.5 percent. The gap between deposit and lending rates, which had increased significantly in the first half of 1983, had been reduced. The authorities had stated that they would continue to keep interest rate policy under review and to keep deposit rates positive in real terms.

Mr. Alfidja said that his authorities would particularly welcome the comments made by Executive Directors on the need for concessional financial assistance, which, together with financial assistance from institutions such as the World Bank and the Fund, should help to achieve the orderly adjustment to which Mauritius remained strongly committed. Several Executive Directors had also pointed to the importance of removing protectionist measures by some industrial countries against Mauritius's exports. The removal of those restrictions was of crucial importance for the achievement of a sustainable current account deficit and a reasonable rate of growth in Mauritius.

The Executive Board then took the following decision:

1. Mauritius has consulted with the Fund in accordance with paragraph 11 of the stand-by arrangement for Mauritius (EBS/83/78, Supplement 2, May 19, 1983) and paragraph 11 of the letter of September 30, 1983 annexed thereto in order to establish the performance criteria subject to which further purchases may be made by Mauritius for the remaining period of the stand-by arrangement.

2. The letter from the Minister of Finance of Mauritius dated March 1, 1984 shall be annexed to the stand-by arrangement for Mauritius and the letters of March 21, 1983 and September 30, 1983, shall be read as supplemented and modified by the letter dated March 1, 1984. Accordingly the performance criteria referred to in paragraph 4(a) of the stand-by arrangement relating to total bank credit and net credit to the Government shall be those specified in paragraph 9 of the letter dated March 1, 1984.

3. Paragraph 4(c) of the stand-by arrangement for Mauritius in EBS/83/78, Supplement 2, May 19, 1983, shall be amended to read as follows:

> "(c) during the entire period of this stand-by arrangement, while Mauritius has any overdue financial obligation to the Fund, or if Mauritius...."

Decision No. 7691-(84/72), adopted
May 7, 1984

2. TOGO - 1984 ARTICLE IV CONSULTATION, AND REQUEST FOR STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1984 Article IV consultation with Togo, together with a request by Togo for a 12-month stand-by arrangement in an amount equivalent to SDR 19.0 million (EBS/84/80, 4/5/84; Cor. 1, 4/30/84; and Sup. 1, 5/2/84). They also had before them a report on recent economic developments in Togo (SM/84/90, 4/27/84).

The staff representative from the African Department reported that on May 4, the staff had received a cable from the Togolese Minister of Finance indicating that domestic arrears had been reduced by CFAF 4.8 billion, which was roughly comparable to the indicative target set for end-March. The cable did not indicate whether the reduction had taken place some time after the end of March, but it was in any case a welcome development since it gave a fairly good assurance that the performance criteria for end-May--a reduction of internal arrears of CFAF 5.3 billion--might be reached.

Mr. Alfidja made the following statement:

The Executive Board has had the opportunity, in the course of concluding regular Article IV consultations and considering stand-by arrangement requests and reviews, to examine extensively developments in the Togolese economy and the economic and financial policies implemented during the last few years. I will therefore confine my observations to the economic and financial policies pursued in 1983, the performance of the economy, and the expectations under the proposed program.

Following a marked deterioration in the economic and financial situation of Togo during the late 1970s and early 1980s, especially in 1982, when the country's external payments arrears reached SDR 162 million (equivalent to about 58 percent and 74 percent of export earnings and government revenue, respectively), the Togolese authorities decided to carry further their adjustment efforts. They adopted a comprehensive financial program in 1983 supported by the Fund and Togo's principal official and private creditors and later by the World Bank. As Directors might recall, the general objective of the 1983 program was to arrest the deterioration of the financial and economic situation of the country and to promote the conditions necessary for a stable economic growth. The focus of the adjustment effort was to improve the budgetary performance, streamline the public enterprise sector, and reduce the relatively high level of external payments arrears.

To provide an environment that would be more conducive to the restoration of internal and external imbalances, the authorities took a number of measures, notably in the areas of pricing and public finance. In line with their policies to provide appropriate incentives to producers and to promote increasing export earnings, the authorities raised the unit producer prices for coffee by 23 percent to CFAF 290, for cocoa by 17 percent to CFAF 275, and for cotton by 15 percent to CFAF 75. The tariffs for electricity and water were also substantially increased to reflect higher production costs and to reduce the drain on the budget while inciting users to save energy.

Regarding the fiscal sector, effective January 1, 1983, the Government decided not only to freeze salaries and promotions but also to impose an additional 5 percent tax on salaries. Furthermore, extremely stringent limitations were placed on recruitment in order to contain the growth of the wage bill. The hardship created by these obviously unpopular measures cannot be overemphasized.

Turning to the outcome of the 1983 financial program, as reported by the staff, all the performance criteria have been met. At end-December 1983, net bank claims on the Government rose by only CFAF 2 billion, well below the program ceiling of CFAF 9.3 billion. Also, the reduction in the external payments arrears through cash payments exceeded the programmed level by SDR 5.4 million.

The observance of the performance criteria by Togo took place in an economic environment that was less than hospitable. Indeed, contrary to expectations, real GDP is estimated to have fallen by nearly 8 percent in 1983 compared with the forecast decline of 3 percent, reflecting the effects of a severe drought, a substantial decrease in regional trade, and cutbacks in capital spending. The shortage of foodstuffs exerted an upward pressure on prices, which on average rose more rapidly than anticipated. Largely as a result of the weak demand for Togo's exports and the effects of the unsettling conditions prevailing in the region, revenue collection was lower than programmed. The lower than forecast total spending of CFAF 94.5 billion in 1983 represents a cutback in real terms of nearly 22 percent relative to 1982. In the same context, the Government's wage bill declined by 16 percent in real terms in 1983. These developments are a further manifestation of the seriousness of the authorities' effort to restrain growth in spending despite the unfavorable social and political repercussions of such strong measures.

Undoubtedly, these financial results could not have been achieved without an intolerable disruption--if not an outright tear--of the socioeconomic fabric of the country had Togo's creditors not granted a generous debt relief. However, as all Directors are aware, the magnitude of Togo's debt problem is such that the cooperation and understanding of creditors will be necessary again in 1984 and beyond.

To promote the adjustment under way, the Government of Togo is requesting Fund financial support for a one-year stand-by arrangement. The general orientation of this program is similar to that of the preceding one. It is aimed at consolidating the gains made in stabilizing the finances of the economy and providing the basis for the resumption of economic development and growth. Emphasis will be placed on further reducing domestic payments arrears and on restructuring public enterprises. The current account deficit is targeted to decrease from nearly 19 percent of GDP in 1983 to 15 percent of GDP in 1984, and, as in the previous program, no new accumulation of external arrears is expected to take place. The macroeconomic developments that are projected for 1984 include a reversal of the decline in real GDP, a slowdown in inflation of 2.5 percentage points, a resumption of export growth, and a revenue expansion of 11 percent coupled with a 12 percent increase in spending largely reflecting higher investment expenditure under the investment program approved by the World Bank. As a result of this projected outlook for revenue and expenditure, the overall fiscal deficit is forecast to remain broadly unchanged at about 7 percent of GDP.

In the real sector, the reversal of the downward trend in total output is predicated upon better weather conditions to achieve a recovery in agricultural production; higher production of cement materials; and expanding public investment. The thrust of policies in this sector is to increase foodstuff and livestock production and to diversify the productive base through a greater involvement of the private sector in industrial activities. In line with suggestions made by several Directors during the midterm review of the 1983 stand-by arrangement last September, the Togolese authorities have reached an agreement with the World Bank on a realistic investment plan covering the period 1984-86.

On the fiscal front, several Directors indicated that the lower than projected overall deficit was due to the higher than anticipated inflow of foreign grants, thus implying that little or no fiscal adjustment actually took place. My authorities do not share this view. Their opinion rests on the fact that large reductions in real terms in several categories of outlays and in total spending took place in 1983 with a further decrease envisaged in 1984. In particular, electricity rates were raised by 20 percent last February, wages and salaries will remain frozen, and the 5 percent solidarity tax will be maintained. In addition, to restrain the growth of the wage bill, the policy of automatic hiring of high school graduates is being terminated. It is also to be noted that the new tax legislation of January 1984 could result in an annual transfer of resources ranging between CFAF 1.5 billion and CFAF 2.0 billion (2-3 percent of tax revenue) from the private and parastatal sectors to the government sector. Therefore, my authorities are of the view that full justice is not given to the country's painful effort to redress the financial imbalances in the economy if these measures are considered inadequate.

With respect to the status of public enterprises, a topic that has occupied the attention of a number of Directors in the past, my authorities are keenly aware of the need to restructure them. They have in fact demonstrated their commitment to do so by closing nonviable ones such as SALINTO, SOTEXEMA, and TOGOFRUIT. However, given the complexity of the issues involved, they prefer to wait for the completion of current studies to enable them to make informed decisions. In instances where studies have been completed and the decision to privatize some state concerns has been made, the Government believes that expediency and shortsightedness should not lead to the disposal of public properties on unreasonably unfavorable terms. Nevertheless, the Government intends to continue to examine, with the assistance of the World Bank, the best remedies to apply to unprofitable enterprises and to seek reasonable offers if necessary. This is clearly apparent from the text in EBS/84/80, Supplement 1.

My authorities are in agreement with the staff appraisal regarding the strong limitation that the heavy debt burden places on the country's resources. The pursuit of the adjustment effort in the years to come is essential to a gradual restoration of the financial and economic balances. In this connection, I would like to reiterate the comment that I made last September to the effect that short of taking extremely contractionary measures of incalculable consequences, the government sector cannot generate enough savings to be applied toward the payment of the debt service and the financing of development projects. Put another way, under prevailing economic conditions, Togo has virtually no room for maneuver in terms of stronger adjustment. In this regard, cooperation between creditors and Togo is more than crucial in order to find meaningful ways to deal with the country's debt problem. The Government of Togo is hopeful that the outcome of the forthcoming debt rescheduling with Paris Club creditors and the others will be as favorable as that of 1983. Looking further ahead, it is the Government's expectation that the Donors Conference scheduled for 1985 will bring results that are beneficial for the country's long-term structural adjustment.

In summary, I would like to emphasize the resolve of my authorities to safeguard the favorable achievements of the 1983 program and to make the pursuit of disciplined economic and financial policies the central thrust of government operations. It is in support of this effort that they are seeking the Fund's assistance.

Finally, I would like to thank the Fund management and staff for the diligence and consideration that they have shown in the course of discussions and negotiations leading, it is hoped, to the conclusion of the Article IV consultation and the approval of the stand-by request.

Mr. de Maulde recalled that when the Board had discussed the previous stand-by arrangement for Togo in March 1983 (EBM/83/44, 3/4/83), some of his colleagues had been somewhat skeptical about the program's chances of success, based on doubts about the determination of the Togolese authorities to carry out the drastic adjustment effort called for. The facts had dispelled that pessimistic view. All the performance criteria had been met and all the corresponding drawings had consequently been made. The success of the 1983 program had not happened by chance, or with the help of more favorable developments than had been assumed under the program. On the contrary, Togo had suffered unforeseen setbacks: the return of exiles from Nigeria, a severe drought hitting the agricultural sector, and the impact of the difficulties experienced by Nigeria on the commercial and industrial sectors of neighboring countries.

The success of the program reflected the resolute commitment of the authorities, and Mr. de Maulde commended their decision to adhere to the agreed policies, despite the political risks at stake. The costs of the adjustment, combined with the internal consequences of the external developments he had mentioned, had been extremely high. For the third consecutive year, real GDP had declined--by 8 percent in 1983--which, given the rate of growth for the population of 2.7 percent, meant that real GDP per capita had been reduced by about 20 percent over the three-year period 1981-83. Although the program for 1984 provided a small resumption in real growth of 1.7 percent, such a rate would remain insufficient to prevent a further reduction in real per capita GDP.

With respect to the conditionality underlying the program, the most important effort appeared to be in the field of fiscal policies, which, as in 1983, would bear the brunt of the adjustment to such an extent that the capacity of the Togolese authorities to react to unforeseen emergencies might be eliminated, Mr. de Maulde commented. Following the 5 percent reduction in nominal wages implemented in 1983 through the setting up of a national solidarity tax, the program would limit personnel expenditures to the level recorded in 1983, which implied that there would be no general salary increase in 1984. According to his calculations, that would entail a 22 percent reduction in real wages for the civil service since the beginning of 1983; he cautioned against possible adverse side effects, such as the loss of competent civil servants and consequent deterioration in the administrative capacity of the country.

With regard to the public enterprise sector, which had been responsible for many of Togo's present problems, Mr. de Maulde noted that a number of actions were under way that should greatly alleviate the burden of that sector on the budget. Various measures aimed at rehabilitating the sector had been delayed in the past, in part due to the complexity of the problem and to the effective but cumbersome procedures of the World Bank. The Togolese authorities were to be commended for taking the necessary actions once the solution had become clear. Unfortunately, the beneficial effects on the budget would remain limited for some time; the debt associated with past unprofitable investments would still have to be financed publicly.

The balance of payments projections and the corresponding debt service scenario were very useful and indicated that the external position would remain constrained for several years, Mr. de Maulde observed. However, the difficulties should not be overemphasized. Residual financing requirements were projected to decline over the next four years and were not so large as to make them impossible to finance. Fiscal policies would have to remain strict in the coming years, and there was no room for mistakes in the selection of investment projects. It would be important to launch the phosphoric acid project only if there was substantial evidence that it would be profitable. Investment appraisal was a difficult job, as illustrated by the World Bank-financed CIAMO cement project, which appeared to have become very costly for Togo's public finances and balance of payments; he hoped that that experience would not be repeated. The creditors of Togo had already demonstrated their goodwill, and he was sure that the continued determination of the Togolese authorities would encourage them to renew their financial support in the near future.

The effort in the years ahead should therefore concentrate on the resumption of higher real growth than appeared in the staff projections, Mr. de Maulde commented. Per capita GDP was currently projected to remain at the same level in the next four years, which implied that the strong adjustment effort of Togo would remain unrewarded. There appeared to be a clear case for vigorous supply side measures through increased involvement of the World Bank. Finally, he had no quarrel with the schedule of purchases in Table 1 of EBS/84/80, and, indeed, would have liked the same phasing to have been applied to Ivory Coast's purchases under the arrangement agreed at the previous meeting (EBM/84/71, 5/2/84).

Mr. de Groote expressed his support for the proposed decisions and his satisfaction with the successful implementation of the various measures set forth in Togo's financial and structural adjustment programs. In spite of that success, which reflected the determined and courageous efforts of the authorities that had enabled quantitative performance criteria to be met, and in spite of the relatively generous rescheduling arrangements made in 1983, the improvement achieved had not sufficed to eliminate external and internal imbalances. In particular, the regional drought had occasioned a series of setbacks in the achievement of the program's economic goals, as opposed to the program's performance criteria. Therefore, adjustment efforts incorporating supply-side measures would have to be sustained for a number of years. In that context, the exemplary cooperation between the World Bank and the Fund had helped in monitoring the many structural changes that had aided in redirecting medium-term investment strategy, public expenditures, rural developments, and the other shifts necessary for Togo to exploit its potential to maximum benefit.

The Bank-approved 1984 investment program, which had targeted CFAF 35.7 billion for government investment, had been cut back by 20 percent in order to contain the fiscal deficit, Mr. de Groote noted. On the other hand, over 80 percent of total public investment projects had been financed by external resources, and the delay in executing a number of projects had been partly caused by the failure to provide sufficient budgetary resources to finance the required Togolese currency counterpart of externally financed projects. He invited the staff to comment on the extent to which that was due to the 20 percent reduction in the 1984-86 medium-term investment program, and on what criteria had been used in deciding which projects should be slowed down or deferred.

He wondered why the new one-year stand-by arrangement included five purchases instead of the usual four, Mr. de Groote said. The staff had stated that "in view of the projected need for exceptional balance of payments financing and debt rescheduling beyond the medium term, the Fund's role will have to be mainly catalytic. This would indicate annual access of not more than 50 percent of quota." In the light of the Board discussion on Ivory Coast at EBM/84/70 and EBM/84/71, including Mr. Kafka's remarks on that occasion, he was not sure that the Board could accept the definition of the Fund's catalytic role implied by the staff, namely, that it would allow use of Fund resources of no more than 50 percent of quota in the case of 12-month stand-by arrangements and 75 percent in the case of 18-month stand-by arrangements. The proposed decision did not seem to clarify that principle.

Mr. Grosche remarked that 1983 had been a turning point for Togo. In contrast with the two previous adjustment programs, the authorities had demonstrated in 1983 a high degree of commitment that had helped them achieve better control of the public finances and eliminate all external payments arrears. It was remarkable that that progress had been made despite a severe drought that had impaired the productive capacity of the agricultural sector.

He agreed with the staff appraisal of Togo's satisfactory performance and supported the proposed decisions, Mr. Grosche said. He had one problem concerning the timing of the first purchase. The staff proposed to make it available upon the Board's approval of the stand-by arrangement although a financing gap remained in 1984, which was an unusual procedure. There seemed to be a firm expectation that the Paris Club would close that gap by agreeing on a rescheduling of Togo's debt in the near future. If the staff could confirm that the expectation was an unusually strong one, he could go along with the proposed decision. However, bearing in mind the principle of equal treatment, the Fund should continue to avoid even the slightest impression that some member countries were treated more favorably than others. The amount of the stand-by arrangement--SDR 19.0 million or 49.5 percent of quota--was in line with the degree of access the Fund had granted in similar cases. It adequately reflected the structural nature of the internal and external imbalances, the member's track record, the adjustment effort, and the catalytic role of the Fund.

Considering the extent of the long-range problems confronting Togo, Mr. Grosche continued, importance had to be attached to a successful reorientation of Togo's overall development program. He was encouraged by the firm belief that the program would be carried out in close cooperation with the World Bank. Steps had been taken to prevent a wasting of scarce resources in the form of nonproductive, sometimes prestige-oriented, projects; he was aware, however, of the problems involved in stopping projects in the pipeline. The difficult external prospects called for investments that would ease the pressure on the balance of payments. In that regard, he noted attempts to process phosphate rock, which would help to diminish Togo's dependence on the vulnerability of world market prices for that particular product. But the huge scale of the project relative to the size of the Togolese economy made a very careful examination an absolute necessity.

The measures undertaken in the fiscal area were welcome, Mr. Grosche said. The reform of the tax system, once completed, should increase revenues and provide positive incentives. On the expenditure side, the wage bill had risen in recent years, both in absolute and relative terms. The freeze on wages and salaries, and the introduction of a national solidarity tax were, therefore, fully justified. But the control of personnel expenditures would be a lengthy task. The cut in other expenditure items was remarkable, underlining the high degree of the authorities' commitment. The restructuring of public enterprises should also reduce the burden for the public budget and should encourage further mobilization of domestic savings. The information provided by the staff in Supplement 1 was reassuring in that regard.

He urged the authorities to continue reforms in the educational sector, Mr. Grosche stated. Expenditures on teachers should be closely monitored and students should be induced to choose fields where the demand for their services could be assured. There was a need for technicians and engineers, whereas the demand for lawyers seemed to be limited.

On monetary and exchange rate policy, Mr. Grosche remarked that Togo had limited room for maneuver due to its membership in the West African Monetary Union. The ceilings on domestic assets and on net credit to the Government seemed to be reasonable. They should contain the pressure on domestic prices, while allowing some expansion of activities in the private sector.

In the years ahead, Togo would be faced by large and only slowly diminishing balance of payments gaps, Mr. Grosche concluded, and it would depend on exceptional balance of payments financing and debt scheduling. Therefore, Togo was well advised to stick to the present program and not to allow any policy slippages.

Mr. Ismael noted with satisfaction that in spite of the severe regional drought and unfavorable conditions in the neighboring countries that had led to a sharp decline in real GDP, the Togolese authorities had managed to implement successfully the 1983 program. All the performance criteria were satisfied, and fiscal and monetary performance was broadly in line with the program. The efforts to reduce the fiscal deficit had required strong political determination on the part of the authorities, and he hoped that they would continue along the path of adjustment toward economic growth while meeting their external debt service obligations.

The key element in the adjustment program for 1984-85 would be a further reduction in the size of the fiscal deficit, Mr. Ismael stated. The new tax code that went into effect early in 1984, together with improved tax administration, should help, but the authorities would need to keep a tight control on operating expenditures. Improvements in investment planning were contemplated and World Bank assistance in that area could prove valuable. Fiscal performance in 1983-84 had already been considerably improved, and it was important for the authorities to consolidate that progress. Therefore, despite the expected improvement in revenue performance, continued expenditure restraint would be needed in view of the heavy debt service obligations. He also urged the authorities to pay greater attention to the performance of state enterprises in order to make them financially viable.

The medium-term balance of payments outlook indicated that Togo would continue to have significant current account and balance of payments deficits, Mr. Ismael remarked, with a sizable financing gap for some years to come. Therefore, in the medium term, large-scale debt rescheduling and continued flows of foreign assistance on concessional terms would be vital for the viability of the external sector. The weak external prospects also underlined the importance of implementing the program firmly.

The exchange rate policy of Togo was based on the situation in the member countries of the West African Monetary Union as a whole, rather than the situation in Togo, Mr. Ismael observed. The Togolese authorities were reported as being happy with that arrangement, but he invited the staff to comment on the appropriateness of their exchange arrangement and on whether the present level of the exchange rate was consistent with the objective of strengthening the external sector in the medium term.

The program under consideration was appropriate, Mr. Ismael commented, and it would bring about a gradual improvement in the external position in Togo. He therefore warmly supported the proposed decisions. However, like Mr. de Groote, he had noted the staff statement that the Fund intended only to play a catalytic role in Togo. Given the structural nature of the problems faced by Togo, an arrangement under the extended Fund facility, entailing larger Fund assistance and a stronger program, might have been more appropriate. He asked the staff to explain why that course of action had either not been recommended or not preferred by the Togolese authorities.

Mr. Clark remarked that it was encouraging that despite adverse external developments, Togo had had some success in implementing the previous year's stand-by arrangement, although perhaps more in terms of performance criteria than in underlying economic developments. Nevertheless, that success was welcome after the poor performance in the previous two years, when two stand-by arrangements had become inoperative. The improved performance during 1983 had been supported by larger than expected grants and debt reschedulings. The authorities seemed ready to tackle the basic problems of the economy.

Regarding the design of the program, Mr. Clark said that he endorsed two features. The relatively modest level of access seemed appropriate, given the weak medium-term balance of payments outlook and the likely continued need for Fund support. In view of the failure of the 1979 and 1981 programs, and the relatively slow pace hitherto of policy adjustment, he welcomed the maintenance of the monthly monitoring procedures and the inclusion of a midterm review.

With regard to policies, Mr. Clark continued, the fiscal stance remained crucial. He welcomed the authorities' intention to reduce the deficit in 1984, although by a small amount. The implementation of the new tax regime after some delay was commendable. On the expenditure side, the authorities were to be congratulated on their success in containing outlays, but he was concerned to read that nonpersonnel expenditure had been cut back in 1983 to a point that "endangered effective administration." He hoped that it would be possible to achieve a better balance in the future. It would also be important for the authorities to avoid further slippages in the planned reform of public enterprises. He welcomed the staff's judgment that recent developments constituted a reasonable assurance that the program limit on government subsidies would be met.

It would be important to focus investment policy on the productive sectors, Mr. Clark continued. He welcomed the redirection of credit by the Central Bank, the reappraisal of the development strategy with the World Bank, and the adoption of the three-year rolling investment program. He invited the staff to comment on how far discussions had progressed between Togo and the World Bank concerning a possible second structural adjustment project. In the agricultural sector, the recent increases in producer prices should stimulate output. He looked forward to assessing the effects when the staff report for the 1985 Article IV consultation was discussed, and meanwhile looked forward to discussing progress on the authorities' supply-side measures at the midyear review.

The balance of payments prospects, both for 1984 and the medium term, were weak, Mr. Clark commented. Receipts from exports of phosphates, as well as from the sale of cash crops affected by the drought in 1983, were projected to rise. But that outcome could not be taken for granted, and he asked the staff to comment on those uncertainties. Further ahead, the outlook was far from encouraging. Large financing gaps and very high debt and debt service ratios were in prospect for 1985-88, suggesting a need for annual rescheduling by the Paris Club on generous terms, together with continued support from the Fund. Because of Togo's long-term use of Fund credit and continued need for support, it seemed appropriate for the Fund to provide support in coming years at about the scale of the present arrangement. In 1983, in addition to rescheduling and some exceptional assistance, the authorities had been able to draw down reserves to meet their financing needs. He wondered to what extent they envisaged doing so in future.

He could support the Article IV decision, but he had two questions concerning the decision on the stand-by arrangement, Mr. Clark said.

Despite the fact that there was an unclosed financing gap, the decision was to be approved unconditionally, on the basis of a rather vague assurance from the Paris Club. He asked, first, whether that assurance was unique to Togo or was it, at least in substance, fairly common? Second, why had it not been proposed to follow the normal practice of making activation of the arrangement conditional on a Paris Club rescheduling agreement?

Ms. Bush recalled that when the previous stand-by arrangement had come before the Board, she had had reasons for not being able to support the program: the inadequacy of fiscal adjustment, an insufficiently defined investment plan for 1983, and uncertainties with regard to donor assistance and debt relief. She was pleased to be able to support the proposed new stand-by arrangement, but she had some misgivings about the medium term. The good news was that significant progress in economic adjustment had been made in 1983, especially with regard to the immediate problems of the fiscal deficit and the development of medium-term public investment plans. The bad news was that Togo had made relatively little progress toward achieving a sustainable balance of payments position.

On the fiscal side, Ms. Bush continued, the authorities had taken action in 1983 that had resulted in reducing the ratio of the public sector deficit to GDP from 6.9 percent in 1982 to 3.4 percent. The improved tax administration and collection measures taken in 1983 should help to generate revenue. The limitation of the nominal wage bill for public employees in 1984 to the 1983 level, following the freeze on hiring, salaries, and promotions in that year, and the maintenance of survey data on civil service employment, should greatly help over the medium term to control those current budget expenditures. Action to reduce the burden on the budget of subsidizing a number of public enterprises continued to merit high priority. The performance criterion in 1984 on the reduction in domestic arrears and the avoidance of new arrears should limit indirect financing of inefficient enterprises. Supplement 1 (EBS/84/80) showed slow steady progress toward restructuring or privatizing some enterprises.

The close cooperation of the Togolese authorities with the World Bank in reorienting public investment policy, including Bank assistance in developing the 1983 investment plan and the rolling 1984-86 investment program, was welcome, Ms. Bush stated. However, she wondered if enough attention had been given to export development in those plans. The continuing emphasis on phosphate exports in the face of uncertainties about future market conditions seemed questionable. In fact, she wondered why the staff had stated that Togo had only limited prospects for export growth.

With regard to monetary policy, Ms. Bush continued, it appeared that growth of monetary aggregates had been modest, despite the continuation of near double-digit inflation. Real interest rates on deposits continued to be somewhat negative, and the savings deposit rate was actually cut by 1 percentage point in 1983. Given the continued very large resource gap, that action did not seem appropriate. The staff had also noted the use of selective credit controls; she remained skeptical about the use of directed credit. Could the staff comment on the justification for such a tool in Togo?

The most worrisome problem was Togo's inadequate rate of balance of payments adjustment, Ms. Bush commented. Even including official grants, Togo had experienced an average ratio of current account deficit to GDP of nearly 11 percent over the past four years, including a ratio of 13.5 percent in 1983. Those were very high figures by international standards. There had been a considerable degree of stability in the real effective exchange rate between 1977 and 1982, with a slight appreciation of the CFA franc in 1983. In view of the limited growth and diversification of exports, and experience with the exchange rate, she wondered whether the exchange rate and other policies were appropriate for stimulating export growth. It was incumbent on the staff to review simultaneously the competitive positions of all countries in the West African Monetary Union in order to draw some conclusions about the effect of their currency arrangements on those positions.

Were necessary certain imports for development projects, Ms. Bush inquired. Were the taxes on imports pushing the cost of imports needed for development projects to levels that discouraged development? She also invited the staff to comment on the importance of re-exports to the economy.

At the end of 1983 the ratio of Togo's outstanding debt to GDP had been well in excess of 100 percent, Ms. Bush recalled; before rescheduling, its debt service ratio based on exports of goods was about 50 percent. Those figures compared with ratios for all of Africa of about 60 percent and 25 percent, respectively. Even after debt rescheduling, the debt service ratio in 1983 and 1984 would be about 35 percent, well above LDC averages. Furthermore, Togo's balance of payments had already benefited from five years of continuous debt relief, and Togo was about to negotiate its fourth Paris Club rescheduling. Nonetheless, the staff's medium-term outlook showed a continuing unfinanced balance of payments gap of substantial size at least through 1988; their report also stated that it might be opportune that official debt rescheduling should continue at least through 1988 and that it might be necessary to reschedule previously rescheduled debt. On the other hand, the report also indicated that there were good prospects for cancellation of a sizable portion of Togo's public debt by Togo's major creditors. Could the staff provide a preliminary estimate of the extent to which debt cancellation might change the medium-term debt repayment profile, and on the likelihood of such cancellation?

Good progress had been made recently in some areas of economic adjustment, Ms. Bush observed. However, balance of payments adjustment had to be pursued vigorously as continued debt relief should not be a substitute for development assistance or for appropriate adjustment. Like Mr. Grosche and Mr. Clark, she noted that there would be a financing gap remaining after the Fund program was put in place. The staff had pointed out that the Paris Club had indicated its willingness to take up rescheduling in 1984 with the Togolese authorities and that any unexpected variations in rescheduling would be dealt with in the August review. Perhaps those were offsetting factors that had led to the proposed decision for an immediately effective program. She invited the staff to comment.

Mr. Kafka stated that he supported the decisions unconditionally. He was impressed by the actions taken by Togo during the 1983 stand-by arrangement. However, he was concerned by a program that involved a fourth year of decline in per capita income. He was particularly concerned that the Fund program was obliging Togo to cut its investment expenditures 20 percent below the World Bank-approved investment program for 1984. Was that an indispensible condition, and was it due to a lack of local counterpart funds, or the debt service burden, despite the prospects of further rescheduling or cancellation of debt? If the problem was a lack of local counterpart funds, it might have been possible for the Fund to step up its financial assistance to a country where the Fund's exposure would remain relatively small, even after several more years of programs. The contribution of additional Fund assistance to raising the debt service burden might conceivably be offset by the relief measures mentioned by the staff.

Mr. Prowse remarked that he supported the proposed decisions. Togo had benefited from the understanding and sympathetic attitude of its creditors, as well as from its comparative advantage with regard to its principal export--phosphate rock.

On the period of adjustment, Mr. Prowse noted that the staff had underlined the important role of the World Bank and had commented on the sometime difficult adjustment of the investment program. He recalled that at the seminar on small tropical island countries (Seminar 84/4, 5/4/84) representatives of those small countries had said that they would trade continuing IMF supervision of their economy for less constraint by the donors on the use of the resources made available to them. In the present case, the staff had drawn up the economic and financial programs against that difficult background. It was not pertinent to insist that the totality of adjustment required had not been achieved to date.

With regard to the external account, some of the staff had projected an overall worsening in the balance of payments and had stated that in the medium term the viability of the external position would depend critically on continued foreign assistance on concessional terms and on debt rescheduling, Mr. Prowse remarked. The staff had also stated that prospects were good for the cancellation of a sizable part of Togo's public debt by its major creditors, and had mentioned the possibility of rescheduling already rescheduled debt. It was expected that a new round of debt rescheduling would be required yearly through the medium term. He wondered whether that was an optimum arrangement for the handling of external debt. Was the prospect of rescheduling year after year the best solution? The cancellation of debt that was in the offing was welcome, but was it more than a short-term palliative? It might be opportune to think again about how to deal with Togo's external debt, drawing lessons perhaps from other countries. He invited the staff to comment on whether the arrangements for handling Togo's external debt were of maximum efficiency.

On the role of the Fund, the staff had stated that because of the projected need for exceptional balance of payments financing and debt rescheduling beyond the medium term, the Fund's role would have to be mainly catalytic, indicating an annual access of not more than 50 percent of quota, Mr. Prowse said. The logic of that staff position was not evident: should the Fund contribute less, the larger the external need and the more difficult the adjustment process? If the Fund was expected to support the country with successive programs over a long period of time, then the ceilings on total access must be considered in light of ongoing prospects. That position might also argue for some adjustment in access limits in such difficult situations. Another aspect of the Fund's catalytic role was that it was imperative where structural problems were enormous and ongoing. None of those arguments implied that the Fund should not provide the maximum amount of financial assistance on a relatively sustainable basis over the medium term. It would be unthinkable for the Fund to approve programs one at a time, arguing that the principal role fell on others in terms of magnitude and that the Fund could reduce the absolute amount of financial support that it would provide. The issue was important and merited further discussion. The justification for a catalytic role should be a long-term commitment to a country approaching the access limits, where structural adjustment would take some time, and where the financing of the debt situation would require a large contribution from others. Beyond that, he was not even sure whether the Fund should continue to stress the "catalytic role." If the basic logic was that the Fund would reduce the amount of its support for the immediate program because it expected to have a long-term association with Togo, then the Board should be looking at a longer-term arrangement. An arrangement under the extended Fund facility might have been more appropriate for Togo.

Mr. Salehkhou said that he supported both decisions. However, he wished to express his chair's concern regarding the all too obvious trend since the 1983 Annual Meeting of continuously reducing the access to Fund resources by developing countries. The growing tendency to curtail members' access to its resources rested on too restrictive an interpretation of the Interim Committee's pronouncements, and ran counter to the current needs and financial requirements of developing countries for resources on affordable terms and conditions. Those needs were felt most acutely in sub-Saharan Africa. Ways should be found to accord the African countries greater access either by taking a more liberal interpretation of the Interim Committee's recommendations on access or through a broader definition of the uniformity of treatment so as to make some exceptions for the countries hardest hit by adverse exogenous factors or those with small quotas. He was not convinced that such a reinterpretation of the principle of uniformity would be in conflict with the spirit of the Fund's Articles.

The 1983 program with the Fund had been geared more toward financial adjustment and in that sense the basic aim of the program had largely been achieved, Mr. Salehkhou remarked. The dual objectives of curtailing expenditures and releasing resources to meet debt service commitments necessitated the implementation of basic financial measures to reduce the budget deficit, improve trade performance, and eventually eliminate external and domestic arrears.

The fiscal measures adopted by the authorities had included far-reaching measures to reduce current and capital expenditures, including a freeze on salaries and new recruitment and an improved expenditure control system for personnel expenditures, Mr. Salehkhou commented. On the revenue side, tax and customs administration had been overhauled to strengthen the tax base and boost tax revenue. However, tax revenues had not met the program target mainly as a result of the reduced pace of economic activity. That shortage, nevertheless, had been more than offset by reduced expenditures, so that on the whole the budget deficit target was within the program norm.

With regard to foreign trade, Mr. Salehkhou continued, exports in 1983 had declined, reflecting a decrease in re-exports. Despite a rise in some export items, including phosphate rock and cocoa, and a relatively small decline in the volume of imports, the trade deficit had increased, leading to a larger current account deficit. However, large inflows of short-term capital had led to a substantial improvement in the overall balance of payments. He asked for comments on the composition of re-exports and the main reason behind their decline.

The real sector had not performed well, Mr. Salehkhou remarked, owing mainly to the effects of the drought, reduced capital expenditures, weak domestic demand, and the worldwide recession. As a result, real GDP was estimated to have declined by close to 8 percent, far exceeding the program target. The investment program of 1983, which had given priority to infrastructure and communications, had fallen short of original expectations. Furthermore, the drought had adversely affected agricultural production. Despite the exogenous obstacles, the development strategy of the authorities had accorded increasing priority to agricultural and rural development, including livestock production and improved management of water resources, encouragement of private industrial investment, and more efficient and cost-conscious enterprises. He welcomed the intention of the authorities, as described by the Minister of Economy and Finance, to continue to overhaul the financial operations of public enterprises, especially the national steel company, with a view to improving profitability. Increased cooperation with and assistance by the World Bank would further help to revitalize the productive sectors of the economy.

The proposed economic program for 1984 was generally sound, Mr. Salehkhou observed, although it seemed that considering the economic stagnation experienced in 1983, investment funds could have been somewhat larger. The 1984 program envisaged a target of 1.7 percent for GDP growth at constant prices, representing a large increase vis-à-vis the 8 percent decline recorded in 1983. In fact, gross domestic investment was slightly below the depressed level of 1983 and 20 percent lower than the World Bank-approved investment program. Much depended on the realization of the 17.5 percent rise projected for exports, which had declined by 8 percent in 1983. Should adverse exogenous factors prevail, increased investments could prove decisive in maintaining the growth momentum projected for the economy. Furthermore, gross domestic savings had increased more than the targeted figure, thus providing ample opportunity for greater investments out of funds generated internally.

The other provisions of the program provided an adequate basis for the program's goals and targets, Mr. Salehkhou considered. In particular, fiscal policy was adequately geared to the main objective of further reducing the budget deficit. The pricing policy of the Government would be geared to harmonizing domestic prices with international price trends and to containing production costs to improve profitability. Such realistic pricing policies were to extend also to public utilities. Monetary and credit policies would continue to remain cautious to alleviate domestic price pressures. The external sector outlook was less certain in view of erratic commodity price movements and other exogenous factors, such as protectionism, world recession, future movements of the terms of trade, and external debt commitments.

Mr. Malhotra commented that his chair supported the proposed decisions. He agreed with Mr. Kafka's remarks on the level of proposed Fund financing. His chair had not accepted the concept of a "catalytic role" for the Fund, especially with regard to Fund financing of weak economies, as it had been set out in several papers submitted for Board consideration, and he was pleased that the issue had been raised in some detail by Mr. Prowse.

At a previous meeting, Mr. Malhotra recalled, he had suggested that the Board should discuss again the question of the Fund's catalytic role with reference to the quantum of its financing; and he had pointed out that there could be a positive as well as a negative connotation to that role. The positive connotation arose when the Fund, by providing adequate finance, helped gear large additional financing for indebted countries from other sources, such as commercial banks. The negative connotation arose from the Fund's interpretation of its role, especially where weaker economies were concerned, as calling for a more restrictive approach and reduced financing. At a previous meeting, a range of 33-50 percent of quota had been mentioned for such weak economies; he did not recall that the Board had approved or endorsed such a rigid range. During the discussion on the criteria for the amount of access in individual cases, while several Executive Directors had expressed sympathy with the suggestions made in the relevant staff paper, many others--perhaps the majority of the voting power--had not approved the ranges cited. He strongly urged that the Board reconsider the matter carefully. The Fund should not hold back adequate support where it was needed most; in maintaining a financing range of 33-50 percent of quota, the Fund could be denigrating the already small quotas of such countries, an approach that might militate against the Fund's principles of nondiscrimination and deny sufficient support to weaker members.

As for the annual debt reschedulings that were forecast for Togo in the next several years, Mr. Malhotra said that, like Mr. Prowse, he wondered whether an annual debt rescheduling exercise was appropriate in the case of highly indebted countries. At a recent meeting of the Group of Twenty-Four, Ministers from developing countries had urged that more imaginative solutions be found to the debt problem. At that meeting it had been brought out that the debt position of many countries was acute, especially in Africa, not to mention Latin America. Therefore, longer-term solutions should be found; ad hoc actions were not appropriate. The development process was being stifled by indebtedness, and the problem warranted substantive and serious treatment by the staff in the near future. There was an increasing realization in banking circles as well as in political circles that something needed to be done; while the initial solutions for dealing with the debt crisis had been appropriate at the time, there was scope at present for reviewing the approach to be taken in future. He urged the staff to present a paper on that issue for Board consideration.

Mr. Zhang said that he supported Togo's request for a new stand-by arrangement for 1984. The Togolese authorities should be commended for their successful implementation of the 1983 program, despite an unfavorable economic environment. The 1984 program assumed an increase in GDP of 1.7 percent in 1984, compared with a sharp decrease of 7.9 percent in 1983. Since gross domestic investment would be kept approximately at the 1983 level, and public and private consumption was expected to fall, the increase in GDP in 1984 would come entirely from an increase in exports. Indeed, the program had projected a sharp increase of 17.5 percent in the value of exports for 1984, based on an 8.3 percent increase in volume and a 9.3 percent increase in prices. According to the program, the volume and price of Togo's main export, phosphate rock, which constituted one third of total exports, would remain unchanged from 1983 to 1984. If so, how could the 17.5 percent increase in exports be realized? If not, what would be the consequences of that failure on the implementation of the other principal elements in the program? The projection for the medium-term growth of exports seemed to be too optimistic.

Because of the staff's view that Togo needed balance of payments financing for the medium term and, keeping in mind Togo's successful implementation of the previous stand-by arrangement, Mr. Zhang wondered why the staff had not recommended an arrangement under the extended Fund facility. Would the authorities return for another stand-by arrangement in 1985? He questioned again the staff's position that the Board had laid down a policy that, when the Fund was playing a catalytic role, the maximum limits for a stand-by arrangement should be "annual access of not more than 50 percent of quota." What was the meaning of the catalytic role in general, and in the case of Togo in particular? Furthermore, the present case seemed to be similar to others considered by the Board recently. Could the staff explain why the content and wording of the present decision differed substantially from other recent decisions that had been adopted?

Mr. Polak commended the Togolese authorities for their implementation of the 1983 program, which showed that the authorities were taking their difficulties seriously; full justice should be accorded to the country for its painful efforts to redress the financial imbalances in the economy. The program for 1984 was satisfactory and he supported the decisions.

The problems of Togo were structural and required deep involvement of the World Bank, and especially of IDA, Mr. Polak commented. The Fund's role was essentially supervisory--seeing that Togo followed policies that would create the financial climate for the success of its development program. Another function was to provide the basis for the successive actions by the Paris Club to reschedule Togo's debt. The repeated rescheduling and, preferably, the cancellation of that debt, were essential. In the circumstances, the amount of access--50 percent of quota--was justified.

The amount of the stand-by arrangement--SDR 19 million--was quite small compared with Togo's gross official reserves, which were estimated at SDR 165 million at end-1983 and which had increased by SDR 100 million over the past three years, Mr. Polak observed. He asked the staff to explain why Togo should hold such large reserves, equivalent to about eight months of imports. For a country with a heavy debt burden, perhaps that was not the best way to use its foreign exchange resources. In addition, for a country that had great difficulty in finding local currency for what were apparently high priority domestic investments, would it not be possible to invest some of that foreign exchange at home?

Finally, like other Directors, he would be interested in knowing in what sense the treatment of Togo by the Paris Club differed from that of other countries, Mr. Polak said. Although he had no difficulty with the staff's suggestion that the first drawing could be made immediately after the Board meeting, he simply wished to know what justification the staff had for its action, compared with its treatment of recent requests from other members.

Mr. Joyce stated that he supported the proposed decisions. The measures the authorities proposed to take were commendable. He agreed with Mr. Prowse and others on the matter of debt rescheduling and the role of the Fund in a country that clearly faced financing problems going beyond the program period.

An attempt must be made to reach an awareness, which he hoped would lead to a greater consensus on the part of all--debtors, creditors, and donors--on the nature of the longer-term financing problems of countries, such as Togo, whose accumulated economic and financial problems could not be dealt with, even within the time span of an extended arrangement, Mr. Joyce considered. He had already commented on those matters earlier in the meeting. It was useless to rest assured that the financing gap could be bridged in the life of the Fund program, if the result would be a compounding of the debt service problem in the future, once the grace period envisaged in the rescheduling arrangements had expired and once repayment obligations to the Fund and others began to mount.

The Fund was doing important work to keep countries afloat, permitting them to stabilize their economy, deal with some of their fundamental structural problems, and begin to restore growth, Mr. Joyce continued. But that was not enough if it presaged an insupportable financial problem in the future. He, like other Directors, had serious reservations about the Fund's "catalytic role" especially in smaller and weaker countries. Like Mr. Malhotra, he accepted that the existence of a Fund program could facilitate additional financial flows from other sources. He also agreed that if the Fund's resources were limited and if continued Fund financing was contemplated--as was often the case with small, weaker economies--it might be necessary to pay out the Fund's resources in a calculated manner. But he resisted strongly any suggestion that the Fund should reduce its financing in the case of such countries and place the onus on others to provide the financing required.

He was also concerned about the increasing references to percentages and guidelines governing the respective entitlements of countries to use the Fund's resources under programs supported by arrangements with the Fund, Mr. Joyce stated. He appreciated the need for guidelines to help the staff negotiate programs and to ensure equality of treatment, but he feared that there was a danger of assuming that those guidelines were definitive and that they should be applied mechanistically. That would be a serious mistake. Each application for Fund assistance must be considered on its merits in the light of all circumstances--including the medium-term prospects--not only for the sake of the country's economy but also in order to provide adequate longer-term financial resources.

Mr. de Maulde expressed his support for Mr. Joyce's comments.

Mr. Kafka said that he also wished to associate himself with Mr. Joyce's remarks. On the question of guidelines, he pointed out that in his first statement on access limits, the Managing Director had said that "a number of Executive Directors noted that the broad thrust of the staff paper, particularly Section II, 'Considerations Governing Amount of Access,' was acceptable to them" (EBM/83/167, 12/2/83). In a later statement, he had noted that "I believe that we achieved broad agreement on the matters set out in EBS/83/270 (12/16/83)...and also the understanding that the broad thrust of the staff paper 'Considerations Governing Amount of Access' would provide guidance to the staff" (EBM/83/183, 12/28/83).

Mr. Malhotra recalled that he too had found the same lack of conformity between the relevant summing up of the later statement mentioned by Mr. Kafka. At the time he had drawn attention to that and had expressed his presumption that it did not mean a departure from the initial position. His presumption had not been questioned.

Mr. Camara said that his chair supported the proposed decision.

The staff representative from the African Department explained that in the Agreed Minutes of the previous year's Paris Club rescheduling, a goodwill clause had been inserted, stating specifically that the Paris

Club creditor countries would give sympathetic consideration to Togo's position if the program with the Fund in the upper credit tranches was in place and if the conditions set out in the Agreed Minutes with regard to rescheduling and repayments had been fulfilled. The staff believed that both conditions had been met. The words "annual reschedulings" had been used because the practice of the Paris Club to date had been to reschedule only on an annual basis or for the duration of a Fund stand-by arrangement.

The medium-term forecast had not included any staff assumptions about debt cancellations, the staff representative continued. However, the staff was aware that two countries had made a decision to cancel a certain amount of debt but had not yet made an announcement. It was expected that France would cancel concessional debt incurred up to 1970. The Federal Republic of Germany would cancel debt amounting to DM 187 million; in 1984, the cancellation would amount to DM 4 million. The calculations of the impact in later years had yet to be made by the German authorities.

With regard to the investment program for 1984, several Directors had commented that the program was for 20 percent less than the amount approved by the World Bank, the staff representative said. The final amount had been discussed with both the authorities and the World Bank, and reflected the immediate absorptive capacity of Togo. In future, the staff would have to accept that the public sector deficit/GDP ratio could rise in the case of an appropriate investment program that was properly financed on a longer-term basis or through grants.

The 12-month stand-by arrangement had been proposed because the staff did not believe that the underlying work for an extended arrangement had been completed, the staff representative commented. Although there was a new three-year rolling investment program worked out in cooperation with the World Bank, a lot of work remained to be done, especially with regard to establishing a proper macroeconomic framework and assessing its impact on the balance of payments and on recurrent expenditures. Considerable progress had been made in investment programming; but while the annual tranche to be disbursed under the three-year rolling investment program had been estimated at CFAF 54 billion, a large part remained to be financed. The World Bank had approved the portion for which financing was available, although that was already a reduction from the annual tranche under the rolling investment program.

The situation pointed to the difficulties in synchronizing the work of the Fund and the Bank, the staff representative continued. Unfortunately, the time frame for taking structural measures and practical adjustments differed from that for demand management measures. That an extended arrangement was not appropriate perhaps indicated that more staff resources and closer cooperation with the World Bank were needed. He assured Directors that the staffs of the Fund and the Bank worked closely together, both in the field and at headquarters; however, the World Bank had difficulty finding promising projects. A lot of human resources and private sector ingenuity had gone into the area of re-exports, which had proved to be a very profitable venture. It was difficult to attract the private sector to productive activities other than commerce; it was a challenge for both the Bank and the Fund staffs to identify projects and to provide incentives. The Togolese authorities were working on a new investment code, to be submitted to the National Assembly during the summer of 1984, that would provide larger incentives to small and medium-sized local enterprises.

On credit policy, the staff representative noted that during the past year, relatively large resources had accrued to the banking system, of which an increasing share had been placed in the West African Monetary Union's money market, and the credit extended in the economy had been falling. The Central Bank had tried to make it easier for certain institutions to provide credit to the small and medium-sized Togolese entrepreneurs. It was noteworthy that all rediscounts with the Central Bank had originated with two banks that had engaged in those activities. The Central Bank's concept of international reserves was a mechanistic one because it was determined in the balance sheet as a counterpart of money, minus the financing that had been provided to the Government. Because lending to the Government was narrowly circumscribed, the concept of reserves was almost a bookkeeping entry; the staff had indicated that the reserves of a particular country were in a sense used to reduce the position of the Monetary Union in the Operations Account, but that the Government itself could not use the reserves.

Considering that the resources of the Fund were relatively expensive and that other financing, including the expected debt rescheduling, was available, access of 50 percent of quota was appropriate for the program under review, the staff representative considered.

It was difficult to assess the adequacy of the exchange rate of a country in a monetary union, the staff representative explained. The exchange rate had not been an obstacle to Togo's major commodity exports, but export diversification under a medium-term program might call for reconsideration of the exchange rate's adequacy. Ultimately, that diversification would depend on the revitalization of the agricultural sector. The World Bank believed, and the Fund staff shared that view, that there had been room for Togo to increase production of food crops for export to a neighboring country, but the serious drought had destroyed those hopes.

Replying to a question by the Acting Chairman, the staff representative of the African Department explained that "reserves" were a claim of the Togolese branch of the Central Bank on the West African Monetary Union. The Government would still have to purchase foreign exchange with local currency, which explained Togo's arrears. The constraint was not the unavailability of foreign exchange, but the Government's lack of local currency resources.

Mr. Kafka, commenting on the cut in the investment program because of Togo's insufficient absorptive capacity, asked for a definition of "absorptive capacity" in Togo's case. Was one aspect the lack of local counterpart funds? If so, it was conceivable that those funds could be created through additional foreign currency loans, for example, through stepped-up participation by the Fund or others, and cancellations or reductions in debt service. Another aspect was the microeconomic absorptive capacity, including the availability of people to run the projects.

The staff representative from the African Department commented that the first aspect had been a problem in 1983, but that at the microeconomic level, detailed project preparation and the availability of technicians would be a problem in 1984.

The Acting Chairman commented that if Mr. Kafka's remarks implied that the Fund should increase its support when domestic currency was insufficient to maintain projects for which foreign economic assistance was available, they raised serious questions about the nature of Fund financing.

Mr. Kafka said that, as resources were fungible, it was not necessary to allocate the Fund's resources to a specific purpose. In the present case, because it was a problem of reducing arrears, an increased rate of reduction might have allowed resources to be used for other purposes.

The staff representative from the Exchange and Trade Relations Department observed that Directors would have an opportunity to discuss the various aspects of access policy during the forthcoming discussion of the paper on prolonged use of Fund resources. On the Fund's role in Togo, he agreed that the language in the paper gave the impression that a mechanistic standard had been applied to the level of access provided to individual countries. In fact, the staff had been guided by the criteria enunciated in the staff paper on the criteria for the amount of access in individual cases discussed at EBM/83/166 and EBM/83/167 (EBS/83/233, 10/31/83). The understanding of staff and management was that there had been a consensus following the discussion. But, as Mr. Kafka had pointed out, some Directors had different perceptions of the results of that discussion, and the issue would be raised at the forthcoming meeting.

Access of 50 percent of quota under the proposed stand-by arrangement for Togo was appropriate because it met the member's balance of payments needs for the present period, the staff representative said. For that reason also, the decision had not been held up contingent on the financing gap being met as a result of subsequent discussions with creditors and donors.

The question had been raised by Mr. Malhotra and Mr. Prowse whether the general application of the access limits to the "catalytic" category of countries had resulted in some form of discrimination to countries with low or weak economies, the staff representative recalled. Two broad considerations determined the access for individual countries: the need of the country, and the need to maintain the revolving character of the Fund's resources. Therefore, the level of access could vary from country to country; in the case of countries with weak balance of payments, it had to be decided how far the Fund could go consistent with the revolving character of its resources. That should not be considered as discrimination against those countries because a uniform principle was applied to all cases.

As to whether annual debt rescheduling was the optimal solution, the staff representative commented that a number of cases discussed by the Board indicated clearly that it was not an optimal approach. For that reason, a medium-term approach to debt rescheduling for individual countries had been suggested in various quarters. The Paris Club had decided recently to adopt the practice of inserting a goodwill clause in certain agreements, whereby a clause could be inscribed, stating an agreement in principle on rescheduling the debts for a further year. The Paris Club had inserted the goodwill clause in the debt relief agreement for Togo in 1983. The Club had agreed in principle to consider another timely meeting to deal with Togo's debt service payments falling due after December 31, 1983, provided that Togo continued to have an arrangement with the Fund involving the use of Fund resources subject to upper tranche conditionality.

On the "catalytic role" of the Fund, the staff representative recalled that Mr. Malhotra had stated that in addition to providing financial support, the Fund's role was also to assist the country concerned in obtaining resources from other sources, either from donors or creditors. For example, when banks seemed to be less forthcoming than expected, the Fund planned to play a catalytic role, although success was not always assured.

With regard to phasing, the staff representative from the Exchange and Trade Relations Department explained that although it was more common to have four installments in a one-year stand-by arrangement, in the case of Togo, provision had been made for five installments, because it had been considered necessary to monitor more closely the performance of the country. In some cases, the lag in data reporting was so long that it might not be possible, even if desirable, to have more than four installments.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/71 (5/2/84) and EBM/84/72 (5/7/84).

3. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/84/90 (5/1/84).

Adopted May 4, 1984

4. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 83/180 are approved. (EBD/84/127, 4/27/84)

Adopted May 3, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and an Advisor to Executive Director as set forth in EBAP/84/89 (5/1/84) and EBAP/84/92 (5/2/84) is approved.

6. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/84/95 (5/4/84) is approved.

APPROVED: October 17, 1984

JOSEPH W. LANG, JR.
Acting Secretary