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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/150

10:00 a.m., October 12, 1984

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	C. A. Salinas, Temporary
	M. Lundsager, Temporary
M. Finaish	
	T. Yamashita
	B. Goos
	S. Sornyanyontr, Temporary
	G. D. Hodgson, Temporary
	H. A. Arias, Temporary
	N. Coumbis
	A. S. Jayawardena
	E. M. Ainley, Temporary
	A. A. Scholten, Temporary
	A. J. Tregilgas, Temporary
	O. Kabbaj
F. Sangare	E. I. M. Mtei
	J. E. Rodríguez, Temporary
	A. Lindø
	J. Bulloch, Temporary
	Wang E.

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

Also Present

African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; A. B. Diao, E. L. Bornemann, F. d'A. Collings, R. P. Kronenberg, T. P. McLoughlin, R. A. Valdivieso. Exchange and Trade Relations Department: E. H. Brau, S. Kanesa-Thasan. Legal Department: J. K. Oh. Treasurer's Department: D. Berthet. Bureau of Statistics: E. Matayoshi. Advisor to Executive Director: J.-C. Obame. Assistants to Executive Directors: W.-R. Bengs, C. Flamant, V. Govindarajan, J. A. K. Munthali, K. Murakami, E. Olsen, J. K. Orleans-Lindsay.

1. EQUATORIAL GUINEA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Equatorial Guinea (SM/84/199, 8/16/84). They also had before them a report on recent economic developments in Equatorial Guinea (SM/84/200, 8/17/84).

Mr. Alfidja made the following statement:

Recent developments in the economy of Equatorial Guinea have been mixed. In the real sector, the output of cocoa, coffee, and timber, the primary sources of export receipts, has remained depressed, compared with past performance. Growth of real GDP, which was estimated at 1.5 percent in 1982, decreased to 1.0 percent in 1983, largely reflecting the continuous decline in cocoa and coffee output, timber production having increased. In the external sector, as well, the overall balance of payments position has come under increasing strain, reflecting rapidly growing external debt service obligations. On the other hand, the budget deficit was estimated to have declined in 1983, due mainly to improved fiscal discipline. Likewise and partly thanks to this better fiscal outturn, domestic credit expanded less rapidly in 1983 than in previous years.

In recognition of the need to reverse the deteriorating economic and financial situation and to exploit the full potential of the country's diversified resource base, the authorities have recently initiated policy actions representing a significant step in the context of a comprehensive stabilization program that will need the financial support of the international financial community as well as friendly countries.

In the public sector, the new system for monitoring fiscal performance on a monthly basis, introduced in 1983, has been further strengthened to ensure greater fiscal discipline. The tariff structure is gradually being changed to conform with that of the UDEAC. Following a review of recent budgetary developments and prospects undertaken in mid-1984, substantial cutbacks in expenditure were initiated in response to important revenue shortfalls. In particular, the size of the civil services is being trimmed. Concerning capital outlays, the implementation of nonpriority projects has been postponed. The authorities are determined to ensure that the expansionary impact of the 1984 overall deficit is minimized. Private sector demand for credit will be more closely scrutinized, giving priority to requests aimed at enhancing the productive capacity of the economy.

An investment program aimed at stimulating domestic food production and encouraging the production of export commodities is under preparation with technical assistance from bilateral and multilateral sources, in the principal areas of agriculture, forestry, mining, and education. The major project under the investment program is the cocoa rehabilitation project. Profitability in the cocoa sector is to be restored through adequate producer incentives.

Adverse developments in the external sector in recent years are partly attributable to the weakness in international prices for the economy's major exports (cocoa and timber) as well as to the effects of the pursuit of expansionary fiscal and monetary policies. The recovery in world demand for cocoa and timber in 1983 and a decline in imports helped to reduce the current account deficit sharply from SDR 23.0 million in 1982 to SDR 14.3 million in 1983. However, as scheduled amortization on external debt increased and private capital outflows continued, the overall balance of payments deficit widened slightly to SDR 16.8 million from SDR 15.8 million. As the staff report indicates, the authorities of Equatorial Guinea do not foresee any substantial improvement in the external sector position in 1984 and immediately thereafter, unless their adjustment efforts in implementing a comprehensive stabilization program are supported with substantial external financial assistance.

The authorities of Equatorial Guinea have stated their determination to pursue the rehabilitation of the economy. They have taken decisive measures and are prepared to further the adjustment effort under way. Furthermore, the authorities have been assured of the necessary technical assistance needed for the effective implementation of an adjustment program. In this connection, they have made significant progress toward establishing a new institutional structure in the international economic and financial relations of the country with its neighbors. This new institutional arrangement should help promote foreign confidence in Equatorial Guinea, support and strengthen the administrative capacity for ensuring efficient economic management, as well as promote a balanced and sustained economic development.

In conclusion, I would like to convey the appreciation of my authorities to donor countries and the Fund for the technical assistance they have continued to provide for the management of Equatorial Guinea's economy.

Mr. Blandin observed that the 1984 Article IV consultation with Equatorial Guinea was undeniably taking place while the country was in the midst of a severe economic and financial crisis, which was of as much concern to him as to the staff. Nevertheless, a positive way to look at the crisis was to consider it as a period of transition that would allow Equatorial Guinea to overcome difficulties inherited from the past and to make a new start on the path towards development.

The most worrisome manifestation of the crisis was certainly the existence of overdue payments to the Fund that had reached the order of SDR 3.2 million, Mr. Blandin continued. The authorities were fully conscious of the gravity of the situation created by those arrears and were doing their best to find a solution that would allow them to discharge their obligations as soon as possible, if only to permit the Fund to respond positively to their request for a program supported by the Fund. Yet the existence of the arrears reflected a weak external position, which in turn was the result of the profound disruption in the productive base during the years following independence. To be sure, the Government that had come into power in 1979 had made a number of efforts in the past few years to reverse the deteriorating trend in the economy. But weak administrative capacity and, above all, the absence of a convertible currency as well as the associated overvalued exchange rate had hampered those efforts. Consequently, the recovery in production had so far been limited mostly to the timber sector; the substantial increases in producer prices for cocoa had induced only a short-lived supply response. Equatorial Guinea was another example of a country that could not take full advantage of its good potential for development. For instance, Equatorial Guinea's cocoa had always been considered the best in the world; timber production could easily be increased to three times the present output; fishing could be significantly developed; and there were good prospects for oil production in the medium term.

Equatorial Guinea would take a major step on January 1, 1985, when it joined the Bank of Central African States (BEAC), thus becoming the fourteenth member of the French franc area, Mr. Blandin noted. From that time on, the country would have a convertible currency, the CFA franc, which together with the accompanying liberalization of exchange restrictions and the monetary reform entailed in membership of the BEAC, should provide a strong incentive for the resumption of production in all sectors of the economy and should lead to the disappearance of the present practices of underinvoicing and overinvoicing.

Nevertheless, all the beneficial effects of BEAC membership would be felt by Equatorial Guinea only if two conditions were met, Mr. Blandin considered. First, the exchange rate between the ekwele and the CFA franc would have to be carefully chosen. He fully agreed with the staff that the centerpiece of any adjustment effort should be major exchange rate action sufficient to restore the profitability of the cocoa sector. In that connection, he had been pleased to note that a technical assistance mission to Malabo was scheduled for the end of October. Second, Equatorial Guinea would have to adopt an adjustment policy, including an appropriately restrained fiscal and monetary stance. BEAC membership would be helpful in that respect. Technical assistance, including that given by the Fund, would also be crucial in remedying existing administrative weaknesses.

In conclusion, it was obvious that adjustment could be achieved more easily if Equatorial Guinea could benefit from a program involving the use of Fund resources, Mr. Blandin said. Therefore, he hoped that prompt repayment of Equatorial Guinea's arrears would permit the Fund to send a mission to Malabo in the near future to negotiate the program requested by the authorities.

Mr. Ainley said that he could generally endorse the staff appraisal and that he supported the proposed decision. The staff reports made somber reading: the economy was clearly performing well below potential; domestic policies had been out of line for some time; the external position was precarious; and debt service obligations appeared unmanageable. To their credit, the authorities had now recognized the need for fundamental policy changes, but they faced a daunting task in trying to restore confidence and rebuild the economy. Quick and decisive action would be required if the necessary external assistance was to be forthcoming and if Equatorial Guinea was to benefit fully from its membership in the BEAC.

Under the circumstances, Mr. Ainley continued, he accepted the priorities and objectives agreed between the authorities and the staff. It would be essential for the authorities, first, to re-establish efficient administrative arrangements to ensure that adjustment could be appropriately planned and carried out; second, to restore fiscal and monetary discipline; third, to make a substantial exchange rate adjustment to encourage domestic production and promote exports, especially as the authorities themselves recognized that the rate had been out of line for a long time and had resulted in damaging economic consequences; and fourth, to implement a realistic development plan aimed at maintaining infrastructure and diversifying the productive base. None of those objectives would be easy to meet, but their achievement was vital if Equatorial Guinea was to emerge from the present crisis and lay the basis for future growth. As Mr. Blandin had said, the country had the potential for growth.

Even if the authorities could carry out such an adjustment program, sizable financing gaps would remain in 1984-85, Mr. Ainley noted. Equatorial Guinea would therefore have to rely in the short term on debt rescheduling and new external assistance. At the same time, such assistance would be forthcoming on an adequate scale only if the authorities could demonstrate convincingly that their policies were back on track. The country had no time to lose and was anxious for the Fund's help, both in mobilizing external assistance and in providing support under a stand-by arrangement.

Both sources of financial support were urgently needed, Mr. Ainley recognized, but Equatorial Guinea's overdue payments to the Fund remained outstanding. He had been surprised that the staff had not examined the prospects for settling those arrears in its report and would be grateful for information about the current position. He understood that Equatorial Guinea had been able to settle arrears to the Fund on two occasions in the past 12 months. The authorities should give high priority to settling present arrears so that the Fund could play a full part in rebuilding the economy.

Mr. Scholten said that Equatorial Guinea was facing an extremely difficult balance of payments situation, but it had prospects for substantially improving it over the coming years. In particular, the country had possibilities for increasing cocoa and timber production, and of improving its foreign exchange system. It was encouraging to note that the authorities seemed to be moving toward the required fundamental reorientation of policies, within the context of a radical change in the domestic institutional framework and prominently featuring international cooperation. For instance, monetary and exchange rate policies would be conducted henceforth in the context of BEAC membership; an arrangement with the Fund was being sought that would focus, in the circumstances, on fiscal and pricing policies in particular; and steps were being envisaged to establish a framework within which donor assistance could be increased and coordinated.

He fully supported the assessment by the staff in its appraisal of the desirable content of the new policies, Mr. Scholten continued, and he hoped that the authorities would move toward their adoption as soon as possible. As for the implications of the intended institutional changes, membership of the BEAC, effective January 1, 1985, would be the most important change. However, he believed that the staff report fell short in spelling out the advantages of BEAC membership and the problems of transition. In joining its neighbors as a member of the BEAC, Equatorial Guinea would obtain major advantages from introducing a convertible currency, but it would be difficult to choose a rate at which the ekwele should be converted into the CFA franc. The official rate of the ekwele was so overvalued that it provided no guidance, yet there was insufficient information in the staff report to offer a clearer guide. It was a sensitive issue, one of particular concern because the authorities had expressed their wish to negotiate a Fund arrangement. On more than one occasion, the inability of a country to take exchange rate action because of its membership of a regional central bank had hampered the design of an adequate arrangement with the Fund. Equatorial Guinea would be similarly constrained from January 1, 1985 onward, and it was therefore essential for it to take the Fund's view into account while it was reaching a decision on the conversion rate.

Additional donor and creditor support would also be required for the success of any program, Mr. Scholten remarked. In turn, adequate donor assistance would require an arrangement with the Fund; Spain had already made debt relief contingent upon Equatorial Guinea having a Fund program. The size of the member's arrangement with the Fund would have to take into account the debt service obligations it would entail. Equatorial Guinea's debt service ratio with respect to its debt to the Fund alone had risen to more than 30 percent in 1984 and 1985. As a member of the BEAC, Equatorial Guinea's debt service obligations would constitute a straight budgetary burden that would have to be taken into account in designing the arrangement with the Fund and determining its amount. Therefore, it was disappointing to note that the member was increasingly in arrears to the Fund, making it impossible for negotiations on a new arrangement to proceed. He fervently hoped that Equatorial Guinea would receive the necessary financial assistance to meet its obligations to the Fund.

Ms. Lundsager noted that Equatorial Guinea was in a serious economic situation, with inappropriate prices harming producer incentives and returning the economy to one of subsistence agriculture. Only drastic change could reverse the situation. As the authorities would be handing over control of monetary and exchange rate policy to the BEAC when Equatorial Guinea became a member in January, all autonomous macroeconomic adjustment would have to come through fiscal policy. The authorities were already aware of the importance of fiscal restraint as shown by their implementation of expenditure controls in the 1984 budget. She welcomed the restriction of the size of the civil service and the postponement of development spending on nonpriority projects mentioned by Mr. Alfidja. The specific rules applied by the BEAC with regard to its members' access to foreign exchange should also help Equatorial Guinea to correct its fiscal imbalance.

On the supply side, Ms. Lundsager continued, the rapid increase in credit to the private sector over several years had not been sufficient to stimulate increased production. The real incentives must therefore lie in prices, including the exchange rate. The lack of data on price levels made it difficult to determine an appropriate exchange rate, although the rate in the parallel market generated by sizable private capital outflows gave a strong indication of how far out of line the official rate was. The critical problem was to determine the rate at which the ekwele would be converted to the CFA franc when Equatorial Guinea adopted the CFA franc as its own currency on joining the currency union. She urged the authorities to set domestic prices at adequate levels when the conversion was undertaken, owing to the extreme importance of increasing production of traded goods--both exports and import substitutes. The prices should reflect costs of production and prices of comparable goods in other BEAC member countries. In addition, petroleum prices should be moved rapidly to world market prices for two reasons: first, to reduce wasteful consumption and, second, to eliminate the drain of subsidies on the budget. Moreover, Equatorial Guinea's major trading partners lay outside the currency union, and she asked what the effect of BEAC membership on trade was likely to be. Would trade with other member countries grow significantly, and would labor be attracted from other member countries, since Equatorial Guinea apparently needed foreign workers to produce cocoa?

In conclusion, Ms. Lundsager remarked, structural reforms were of the utmost priority in Equatorial Guinea. In addition, the country's history of inappropriate macroeconomic policies argued for more frequent consultations with the Fund, as recommended in the staff appraisal. Equatorial Guinea clearly would have a balance of payments need over the short term, and a Fund arrangement would help the authorities implement a viable and comprehensive adjustment program. However, the authorities would need to adhere to a strong adjustment effort, especially as debt service payments to the Fund were already high. Payments to the Fund that were at present in arrears would have to be settled, and the necessary foreign exchange provided to enable Equatorial Guinea to make future payments to the Fund in order not to jeopardize the continuation of a program once it had been implemented. Fund-supported programs could not possibly give the country all the balance of payments assistance it needed, and the cooperation of donors remained crucial. She agreed with the staff that the introduction of a complete macroeconomic policy package would provide donors with the assurance that their assistance would be well utilized. Finally, she supported the proposed decision.

Mr. Sangare commented that it was opportune to discuss the 1984 Article IV consultation with Equatorial Guinea at a time when the authorities were preparing to put a stabilization program in place by the end of the year. There was no doubt in his mind that Equatorial Guinea would benefit greatly from implementing a strong and comprehensive adjustment program. Such a program should halt further deterioration in the economic and financial situation and help the country in the transition to the new financial and institutional arrangements in prospect as a result of its membership in the BEAC. He understood that one major problem standing in the way of prompt action on a possible Fund-supported program was that payments were overdue on repurchase obligations to the Fund, and he therefore urged the authorities to discharge those obligations as soon as possible.

It was clear that Equatorial Guinea had not exploited its full economic potential, Mr. Sangare continued. The staff report indicated that the economy had suffered successive declines in real output in recent years, exacerbated by expansionary fiscal and monetary policies, and hence a further weakening of the external payments position. There was an urgent need to reduce those imbalances and to create conditions for the resumption of growth. It was encouraging to note that the authorities were well aware of the measures needed to achieve those objectives and that they stood ready to implement them.

One of the essential ingredients in the adjustment process would be a well defined investment program to provide the appropriate medium-term perspective and to promote economic growth, Mr. Sangare remarked. However, lack of administrative capacity had so far hampered the formulation and implementation of development projects. The authorities recognized the importance of technical assistance in the immediate future if the execution of projects was to improve. He hoped that such assistance would be forthcoming and that parallel programs would be put in place for training local personnel. He would also like to highlight data collection as another area in which technical assistance would be useful. Needless to say, a reasonable data base was always important in formulating a meaningful and coherent adjustment program.

Finally, Mr. Sangare noted, the staff was advocating substantial exchange rate action as part of the package of measures to be taken within the context of a Fund-supported program. While he had no difficulty agreeing with the staff, he wondered how that proposal fitted in with Equatorial Guinea's decision to join the BEAC early in 1985. He asked the staff how it saw the exchange rate evolving when Equatorial Guinea finally acceded to the BEAC and the new institutional arrangements became effective.

The staff representative from the African Department explained that when the staff reports had been issued, Equatorial Guinea's overdue obligations to the Fund had been slightly in excess of SDR 1 million. Since then, a number of repurchase obligations had fallen due and had not been discharged. However, a partial payment of SDR 183,000 had just been received, and a further payment of approximately SDR 830,000 was expected momentarily. Equatorial Guinea's total overdue obligations would then be reduced to SDR 2.2 million. During the Annual Meetings, the staff had had extensive discussions with the delegates from Equatorial Guinea and had received assurances that the repurchase obligations would be settled as quickly as possible. The delegates had explained that poor communications with both the Fund and correspondent banks were one reason for the frequent incurrence of overdue obligations to the Fund.

In response to a further question by Mr. Ainley, the staff representative said that unlike most countries, Equatorial Guinea did not have a reliable method of communicating with the outside world. At present, there was no telex in operation, and the only means of communication was by radio telephone or, occasionally, by cable. Due to technical problems, even those links were often interrupted for protracted periods, making normal communications effectively impossible. The problem was under review, and it was hoped that a permanent solution would be found early in 1985.

As for the type of program for Equatorial Guinea that could be supported by use of Fund resources, the elements of such a program had been discussed with the authorities over a long period and agreement on many of them had been reached during a mission to Malabo in June 1984, the staff representative mentioned. However, because Equatorial Guinea was to join the BEAC at the beginning of 1985, it had been decided to postpone any exchange rate action to a date closer to membership. Intensive discussions on the issue had taken place between the staff, the authorities of Equatorial Guinea, and the present members of the BEAC. A further meeting was expected to be held in Malabo at the end of October when a decision would be taken on the rate at which the ekwele would be converted into the CFA franc. The Fund would be represented at that meeting, and it would also provide technical assistance to Equatorial Guinea and the BEAC; it was therefore reasonable to assume that the Fund's view would be made known.

In the short run, there was not likely to be much trade between Equatorial Guinea and other members of the BEAC, the staff representative from the African Department explained, given the current composition of Equatorial Guinea's exports and its import needs. However, BEAC membership and the ensuing currency convertibility should greatly facilitate the task of attracting additional labor that Equatorial Guinea needed so much to restore the full productive potential to its cocoa sector.

Mr. Alfidja confirmed the commitment of the Equatorial Guinean authorities to settle their arrears to the Fund. They were fully aware that negotiations for a stand-by arrangement could not be resumed unless overdue payments were settled. In the meantime, the authorities were already trying to start implementing a stabilization program that was needed in any event. The implementation of that program was not, of course, a condition for Equatorial Guinea's entry into the BEAC.

A decision had already been taken to improve greatly communications between Equatorial Guinea and its neighbors, as well as with its correspondents in Europe and in the United States, Mr. Alfidja stated.

The Acting Chairman made the following summing up:

There was general agreement among Directors who spoke with the thrust of the views expressed in the staff appraisal in the report for the 1984 Article IV consultation. They noted that Equatorial Guinea faced a depressed economy and a very difficult economic and financial situation, including a low level of reserves, an accumulation of external payments arrears--including those to the Fund--and a rising external debt. Directors agreed that the situation resulted from a variety of factors, including the pursuit of inappropriate domestic policies, weak administrative capacity, and an overvalued exchange rate. They emphasized the urgency of decisive corrective measures, both with respect to domestic policies and the exchange rate.

Directors noted the significant long-term productive potential of the economy and the authorities' investment program designed to stimulate food production and the rehabilitation of the cocoa and timber sectors. Directors also welcomed the commitment by the authorities to undertake a comprehensive adjustment program and the steps being taken in that connection to improve monetary and fiscal discipline.

Directors also took note of Equatorial Guinea's pending entry into the Bank of Central African States (BEAC), scheduled for January 1, 1985, and of the positive influence that an appropriate exchange rate and currency convertibility would have on the revival of confidence, provided that BEAC membership was accompanied by appropriate fiscal and monetary policies. In that context, Directors attached special importance, during the transition period, to setting domestic prices at adequate levels following conversion of the currency to the CFA franc. While noting the broad agreement between the authorities and the staff on the thrust of policies to be pursued in order to restore internal and external equilibrium, Directors stressed that, even with appropriate adjustment policies, Equatorial Guinea would be faced with sizable financing gaps that could only be closed through the mobilization of significant additional resources from donors and creditors and through debt rescheduling to support the adjustment effort.

Directors urged the authorities to make prompt settlement of arrears to the Fund, observing that such action would lay the basis for discussions on a Fund program in support of the domestic and external adjustment effort, and facilitate the mobilization of resources from donors and creditors. Directors also noted the continued need for foreign technical assistance and urged the authorities to take appropriate action to ensure that such assistance was obtained and effectively utilized.

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

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Equatorial Guinea's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Equatorial Guinea, in the light of the 1984 Article IV consultation with Equatorial Guinea conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Equatorial Guinea maintains restrictions on payments and transfers for current international transactions and multiple currency practices, as described in SM/84/199 and SM/84/200. The Fund welcomes the intention of the authorities to liberalize exchange restrictions and to eliminate the existing multiple currency practices at the time of entry into the BEAC, scheduled for January 1, 1985. In the meantime, the Fund grants approval of the restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/84/199 and SM/84/200 until December 31, 1984.

Decision No. 7824-(84/150), adopted
October 12, 1984

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/149 (10/10/84) and EBM/84/150 (10/12/84).

2. PEOPLE'S REPUBLIC OF THE CONGO - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1984 Article IV consultation with the People's Republic of the Congo to not later than November 5, 1984. (EBD/84/266, 10/9/84)

Decision No. 7825-(84/150), adopted
October 11, 1984

3. WESTERN SAMOA AND FIJI - TECHNICAL ASSISTANCE

In response to requests from the authorities of Western Samoa and Fiji for technical assistance, the Executive Board approves the proposal set forth in EBD/84/261 (10/4/84).

Adopted October 10, 1984

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/208 (10/9/84) is approved.

APPROVED: July 15, 1985

LEO VAN HOUTVEN
Secretary