INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/159

3:00 p.m., October 31, 1984

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
C. H. Dallara	M. Lundsager, Temporary
	P. Péterfalvy, Temporary
B. de Maulde	X. Blandin
A. Donoso	M. Teijeiro
M. Finaish	T. Alhaimus
H. Fujino	T. Yamashita
G. Grosche	
	M. Rasyid, Temporary
R. K. Joyce	L. Leonard
A. Kafka	
	N. Coumbis
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
F. Sangare	
M. A. Senior	J. L. Feito
J. Tvedt	A. Lindå
N. Wicks	
Zhang Z.	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: R. P. Kronenberg, T. P. McLoughlin, E. van der Mensbrugghe. Central Banking Department: P. Duvaux. European Department: B. Rose, Deputy Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; E. H. Brau, J. A. Clement. External Relations Department: C. S. Gardner, Deputy Director. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: G. P. Nicoletopoulos, Director; J. M. Ogoola. Middle Eastern Department: S. H. Hitti. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Berthet, T. B. C. Leddy. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, R. A. Elson, J. Ferrán. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, L. K. Doe, K. A. Hansen, H.-S. Lee, A. Steinberg, M. A. Weitz. Assistants to Executive Directors: J. R. N. Almeida, R. L. Bernardo, M. B. Chatah, C. Flamant, V. Govindarajan, N. Haque, D. Hammann, G. D. Hodgson, J. M. Jones, H. Kobayashi, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, Shao Z., S. Sornyanyontr, A. J. Tregilgas, B. D. White, A. Yasseri.

1. GUINEA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Guinea together with a proposed decision concluding the 1984 Article XIV consultation (SM/84/226, 10/15/84). They also had before them a report on recent economic developments in Guinea (SM/84/233, 10/22/84).

The staff representative from the African Department remarked that during the consultation discussions the authorities had stated their intention of undertaking a comprehensive adjustment effort at the beginning of 1985. During the 1984 Annual Meeting, they had asked the staff to visit Guinea to help in the design of a suitable adjustment program; in response to that request, a staff team had been in the country since October 21 and was expected to return to the Fund on November 2. A World Bank mission was also in Guinea, and had been cooperating closely with the Fund team. He had just returned from the capital on October 30, having participated in useful discussions that, while focusing mainly on required policy changes, had also touched on required institutional reforms and the need for technical assistance. The staff team was providing the authorities with specific suggestions on elements of an appropriate adjustment program. If the authorities requested a full-scale negotiating mission, it would likely take place in early 1985.

In September 1984, the Fund had provided Guinea with technical assistance in monetary and balance of payments statistics, the staff representative explained. A staff member from the Bureau of Statistics was scheduled to return to Guinea in December 1984 to help the authorities implement a new system for recording monetary statistics. A staff member from the Central Banking Department had visited Guinea in mid-October, and consideration was being given to stationing three Central Banking Department experts in the country in the near future. The provision of technical assistance in other areas was also under active consideration.

Mr. Sangare made the following statement:

> The economic and financial situation in Guinea has remained difficult in recent years. With a recorded annual GDP growth of about 1.6 percent, per capita income continued to decline during 1979-83. Major imbalances have prevailed in both domestic and external finances, aggravated by adverse external environment and inadequate policies. The measures taken in 1982 by the previous Government to arrest the economic deterioration, including some liberalization initiatives, did not go far enough, as the problems have become deep seated and structural, requiring fundamental policy changes.
>
> The serious economic and financial difficulties have therefore been a major concern to the new military Government,

and it has accorded top priority to a reformulation of economic policies. It has stated clearly its strong commitment to reinforcing economic liberalization by minimizing government intervention in the economy, promoting private sector activity, reducing market distortions, and encouraging foreign investment. As a first step, the new authorities have removed obstacles to the free interregional mobility of goods, liberalized agricultural production and marketing, and abolished the monopolistic import-export state enterprise (IMPORTEX) while undertaking preparations to introduce new investment laws.

The authorities also agree that the economic problems of Guinea require a comprehensive adjustment program rather than a piecemeal approach to economic policy. They believe that, owing to the structural nature of the problems that they face, such a program would have to be designed within a medium-term framework in order to give due attention to issues relating to the long-term transformation of the economy as well as addressing the immediate short-term problems. It is their hope that such a program will be finalized in the near future within the context of Fund-supported arrangements. In view of the lack of reliable data, priority attention is being directed at improving the statistical base of the country, and the authorities are grateful to the Fund, the World Bank, and friendly governments that have agreed to provide help in this regard.

The authorities accord particular importance to accelerated development of the country's richly endowed agricultural sector. The primary objective is to attain self-sufficiency in food production by 1985. The policy of the Government is therefore aimed at improving production incentives and marketing arrangements as well as increasing private sector activity. Thus, the collective farming system has been eliminated and the marketing boards, which used to impose limitations on movement of goods between regions and restricted farmers' freedom to price and sell their products, have been dismantled. These efforts are to be complemented by the development of physical infrastructure, such as irrigation facilities and feeder roads, which will help the market system to be efficient, as well as by steps being taken to increase the availability of basic inputs.

A new development plan is expected to become effective in 1988. One of the basic goals of the plan would be to direct resources to the most productive projects and to establish clear guidelines to ensure efficient investment selection and implementation. A technical assistance project in planning and statistics has been discussed with the World Bank to help with the formulation of the plan. It is expected that a donors' conference would be organized in 1985 in consultation with the United Nations Development Program (UNDP) and the World Bank.

1. GUINEA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Guinea together with a proposed decision concluding the 1984 Article XIV consultation (SM/84/226, 10/15/84). They also had before them a report on recent economic developments in Guinea (SM/84/233, 10/22/84).

The staff representative from the African Department remarked that during the consultation discussions the authorities had stated their intention of undertaking a comprehensive adjustment effort at the beginning of 1985. During the 1984 Annual Meeting, they had asked the staff to visit Guinea to help in the design of a suitable adjustment program; in response to that request, a staff team had been in the country since October 21 and was expected to return to the Fund on November 2. A World Bank mission was also in Guinea, and had been cooperating closely with the Fund team. He had just returned from the capital on October 30, having participated in useful discussions that, while focusing mainly on required policy changes, had also touched on required institutional reforms and the need for technical assistance. The staff team was providing the authorities with specific suggestions on elements of an appropriate adjustment program. If the authorities requested a full-scale negotiating mission, it would likely take place in early 1985.

In September 1984, the Fund had provided Guinea with technical assistance in monetary and balance of payments statistics, the staff representative explained. A staff member from the Bureau of Statistics was scheduled to return to Guinea in December 1984 to help the authorities implement a new system for recording monetary statistics. A staff member from the Central Banking Department had visited Guinea in mid-October, and consideration was being given to stationing three Central Banking Department experts in the country in the near future. The provision of technical assistance in other areas was also under active consideration.

Mr. Sangare made the following statement:

> The economic and financial situation in Guinea has remained difficult in recent years. With a recorded annual GDP growth of about 1.6 percent, per capita income continued to decline during 1979-83. Major imbalances have prevailed in both domestic and external finances, aggravated by adverse external environment and inadequate policies. The measures taken in 1982 by the previous Government to arrest the economic deterioration, including some liberalization initiatives, did not go far enough, as the problems have become deep seated and structural, requiring fundamental policy changes.
>
> The serious economic and financial difficulties have therefore been a major concern to the new military Government,

and it has accorded top priority to a reformulation of economic policies. It has stated clearly its strong commitment to reinforcing economic liberalization by minimizing government intervention in the economy, promoting private sector activity, reducing market distortions, and encouraging foreign investment. As a first step, the new authorities have removed obstacles to the free interregional mobility of goods, liberalized agricultural production and marketing, and abolished the monopolistic import-export state enterprise (IMPORTEX) while undertaking preparations to introduce new investment laws.

The authorities also agree that the economic problems of Guinea require a comprehensive adjustment program rather than a piecemeal approach to economic policy. They believe that, owing to the structural nature of the problems that they face, such a program would have to be designed within a medium-term framework in order to give due attention to issues relating to the long-term transformation of the economy as well as addressing the immediate short-term problems. It is their hope that such a program will be finalized in the near future within the context of Fund-supported arrangements. In view of the lack of reliable data, priority attention is being directed at improving the statistical base of the country, and the authorities are grateful to the Fund, the World Bank, and friendly governments that have agreed to provide help in this regard.

The authorities accord particular importance to accelerated development of the country's richly endowed agricultural sector. The primary objective is to attain self-sufficiency in food production by 1985. The policy of the Government is therefore aimed at improving production incentives and marketing arrangements as well as increasing private sector activity. Thus, the collective farming system has been eliminated and the marketing boards, which used to impose limitations on movement of goods between regions and restricted farmers' freedom to price and sell their products, have been dismantled. These efforts are to be complemented by the development of physical infrastructure, such as irrigation facilities and feeder roads, which will help the market system to be efficient, as well as by steps being taken to increase the availability of basic inputs.

A new development plan is expected to become effective in 1988. One of the basic goals of the plan would be to direct resources to the most productive projects and to establish clear guidelines to ensure efficient investment selection and implementation. A technical assistance project in planning and statistics has been discussed with the World Bank to help with the formulation of the plan. It is expected that a donors' conference would be organized in 1985 in consultation with the United Nations Development Program (UNDP) and the World Bank.

The authorities have noted the staff's recommendation of a major exchange rate adjustment. They are aware of the overvaluation of the syli and are agreed on taking adequate exchange rate action to be implemented in the context of a comprehensive policy package, including measures that specifically address supply rigidities and the availability of adequate financial support to ease the foreign exchange bottlenecks.

In public finances, steps are being taken to establish a comprehensive accounting system in order to facilitate effective control of expenditure. Moreover, efforts are being made to restrain the growth in expenditure, including limitations on public employment and wages, even though real wages have declined considerably in recent years and there are strong pressures to accommodate the returning nationals. Transfers to public entities, which have been a major cause of the large budget deficit and excessive credit expansion, will also be limited. Similarly, in 1984 the authorities will further reduce capital outlays, which actually declined in 1983, by allocating funds only for maintenance and rehabilitation of existing projects.

On the revenue side, the authorities envisage a comprehensive review of the tax structure and administration over the medium term. However, considerable technical assistance will be needed. It is to be noted that tax receipts are expected to rise by 35 percent in 1984, reversing the sharp decline in 1983. If this materializes, the overall budget deficit in 1984 is expected not to exceed GS 2.8 billion, compared with GS 6.3 billion in 1983.

With regard to the parastatal sector, the authorities have reiterated that an effort will continue to be made to improve the performance of public enterprises. On the basis of a detailed study now nearing completion, the authorities intend to close nonviable entities and implement strict measures to ensure the viability of the remaining ones. In the meantime, consideration is being given to the need to increase tariffs, enforce collection of accounts receivable, and ways to ensure more realistic cost/price relations. In this regard, technical assistance is being sought from the World Bank.

Credit development in Guinea has been directly related to the public sector's budget position, and particularly the financing needs of public enterprises. Bank credit to the private sector has been marginal. It is the authorities' intention to reduce public sector recourse to bank credit and to re-examine the existing institutional structure with a view to ensuring access of the private sector to bank credit. They believe that the expected improvement in the fiscal position should enable a sizable portion of bank credit to be directed to the private sector. The authorities have also taken note of the need for a more active interest rate policy.

In the external sector, the improved performance of exports in 1983 is expected to continue through 1984 as a result of increased bauxite and diamond exports. Even with a 13 percent increase in imports, the trade surplus is projected to grow by SDR 20 million in 1984. However, a major problem in the balance of payments position of Guinea appears to be large net capital outflows. Despite an expected improvement in the current account, which is projected to record a SDR 7 million surplus in 1984, a large overall deficit has been projected. The authorities agree that the weak external payments position is in part a reflection of the distortions that prevail in the domestic economy. They hope that the comprehensive adjustment program that they intend to undertake would attack the roots of the imbalances. The authorities are also aware of the external debt position and the increasing debt service cost. They plan to seek multilateral debt relief in their effort to resolve the problem of external arrears.

The Guinean military Government intends to work in close collaboration with the Fund and the World Bank in formulating and implementing a comprehensive adjustment program. To this end, they have approached the two institutions for technical and financial support. Transforming a centrally planned economy into a market-oriented one is no doubt a difficult task that would require considerable support from multilateral and bilateral agencies. Exceptional balance of payments assistance over the medium term, including debt relief, would be essential in support of the authorities' efforts to adopt an adjustment program. Taking account of this, it is hoped that the discussions now under way with the Fund, the World Bank, and bilateral creditors will lead to the achievement of this objective.

Mr. de Maulde remarked that the Article IV consultation was timely, as a staff mission was opening discussions with the authorities that could lead to the adoption of a major adjustment program supported by Fund resources. The present report would provide a good foundation for the discussions, despite Guinea's very poor data base; the staff had had to rely on official data that were often insufficient or biased.

Guinea's economy had several striking features, Mr. de Maulde said. For instance, over the previous 25 years, a large gap had emerged between the potential and the actual development of the economy. Guinea enjoyed a remarkable endowment of natural resources, including abundant rainfall, soil that was well suited for cultivation and livestock breeding, and numerous mineral deposits. On gaining independence, Guinea had been a major exporter of agricultural products. The country's development had been thwarted by structural weaknesses, such as the lack of managerial capacity and a poor institutional framework, particularly in the financial area, and by the maintenance of inappropriate economic policies over a long period, despite clear evidence that they had not been working.

a long period, despite clear evidence that they had not been working. The policies had been aimed primarily at giving the Central Government a tight grip on the economy through various controls over production, distribution, consumption, and the relations between Guinea and other countries. The most obvious result of the controls was the distorted structure of official prices. Experience in many countries had underscored the important role in decision making of relative prices, and Guinea was a clear example of how distorted official prices gave wrong signals and provided incorrect incentives to producers. As the staff report had clearly shown, the official exchange rate had become particularly distorted; instead of playing a role as an indicator of the competitiveness of the Guinean economy, it had gradually become unrealistic.

It was paradoxical that, by trying to maintain comprehensive controls, the Government had spread itself thin and the official economy had shrunk to a small portion of the overall economy, Mr. de Maulde commented. Moreover, the government sector consisted mainly of an overstaffed civil service, a large and deficient public enterprise sector, and the agricultural state farms. The official economy had been able to survive only because it included the mixed enterprises of the bauxite sector, which accounted for 96 percent of official exports. During recent years, as government controls had become increasingly relaxed and inefficient, a parallel economy had developed, leading to the creation of a market-determined pricing system, including a dual exchange rate. There was some evidence that the parallel economy was relatively thriving, with a large volume of unofficial, unrecorded exports and imports.

The present economic situation was probably unsustainable, Mr. de Maulde considered. A modern economy could not develop without a basic infrastructure in education, health, and transportation, together with an efficient central government. The Guinean Government had been crowded out of the real economy and lacked the resources needed to perform elementary functions. Guinea also lacked the financial and banking system required to channel credit to the productive sector; the private sector had been deprived of access to credit.

Major adjustments were needed if Guinea were to resume the path toward sustainable development from which it had strayed for a long period, Mr. de Maulde commented. It was encouraging to note that the new authorities were convinced of the need for such adjustment, which would be aimed at liberalizing the economy and making economic developments more reliant on the interplay of market forces. They were to be commended for having already taken a number of steps in the right direction, but major steps still had to be taken, beginning with a monetary reform that would pave the way for the unification of the official and parallel economies. A realistic exchange rate should be the centerpiece of the monetary reform. The convertibility of the syli should be re-established--at least for current operations--to avoid the reappearance of a parallel foreign exchange market based on a discounted exchange rate. To that end, the advice of the Fund would be essential.

Another prerequisite for restoring normal economic conditions was the creation of an efficient banking system based on normal commercial practices and able to respond to the credit needs of the private sector, Mr. de Maulde continued. In addition, considerable technical assistance was needed to rebuild sound and efficient institutions in such basic areas as central banking, tax and customs administration, and the identification of viable investment projects. He was pleased that technical assistance had already been provided by the World Bank, the Fund, and various bilateral agencies, and he hoped that other potential sources of such assistance would be identified. The assistance should be closely coordinated, under the leadership of the World Bank, to avoid unnecessary duplication and contradictory advice. The task of helping the Guinean authorities to rebuild their economy obviously required close cooperation between the Fund--which was responsible for supporting the adjustment effort--and the World Bank, which should help to fit that effort into a medium-term development framework. His authorities intended to follow developments closely to support the effort to assist Guinea.

Mr. Tshishimbi remarked that for many years Guinea had faced large financial imbalances owing partly to structural deficiencies and external factors, but largely to the maintenance of inappropriate policies over a long period. In describing Guinea's structural problems, the staff had stressed the extensive restrictions on the movement of goods and individuals within the country, the huge and inefficient public enterprise sector, and the many rigidities in agricultural production and marketing.

The authorities' policies had caused widespread cost and price distortions, particularly the overvalued exchange rate, Mr. Tshishimbi continued. Although Guinea enjoyed a rich mineral endowment and considerable agricultural potential, the structural and policy deficiencies had caused real per capita income to decline steadily since the late 1970s; in 1983, the real GDP growth rate had been only half the rate of growth of the population, particularly because of the weak performance of the productive sector. Public finances had also deteriorated in 1983, due mainly to the substantial decline in government revenue. Moreover, in both 1982 and 1983, public enterprises had required large subsidies because of their accumulated operating losses. The authorities had indicated that, in future, they intended to limit such transfers to exceptional cases. A study of the overall operations of the public enterprises had nearly been completed, and the authorities were considering an increase in tariffs and other measures to ensure a more realistic relationship between costs and prices; in that connection, they planned to request technical assistance from the World Bank.

Monetary and credit developments in 1983 had been influenced largely by developments in public finance, Mr. Tshishimbi remarked. The expansion of domestic credit had reflected essentially the financing of the government deficit.

Ms. Lundsager remarked that the new Government had made an admirable effort to reorient economic policy. The disbanding of the state trading enterprise and the increased role of market forces were welcome, and the authorities should be encouraged to take additional steps to decontrol economic activity.

Further improvements in Guinea's data base were needed to enable observers to determine accurately the responsiveness of the economy to various policy changes, Ms. Lundsager said. In that connection, the Fund's ongoing technical assistance should be helpful.

The exchange rate was obviously overvalued, Ms. Lundsager continued; the exchange rate in the parallel market was ten times the official rate. It was difficult to determine precisely the appropriate exchange rate in the absence of a comprehensive price index to measure relative prices. Nevertheless, the authorities should not postpone action on the exchange rate until all the relevant data were available; rather, they should start with a sizable exchange rate adjustment forthwith and make further adjustments thereafter.

The liberalization of the agricultural sector and the increase in producer prices for export crops were welcome, Ms. Lundsager commented. The production and sale of domestically consumed food crops seemed to have been fully restored to the private sector, but domestic production would not be adequately responsive as long as the price of imported rice remained low because of the overvalued exchange rate. Production of food crops could best be spurred by adjusting the exchange rate and permitting the effects to be passed through to import prices.

Recent trends in the fiscal sector were encouraging, although additional steps were needed, beginning with the adoption of a consolidated government budget, Ms. Lundsager continued. If the private sector were to develop, it must have access to credit; therefore, the present, fully accommodative monetary policy must be reformulated, and the Government's recourse to debt financing should be reduced. The central government budget deficit was projected to decline in 1984, but it was still large in comparison with the deficits in 1980-82. The authorities' efforts to control current expenditure, including the limitation of civil service hiring, were welcome. Given the limited savings capacity of the domestic economy, the authorities had decided to limit investment expenditure to maintenance and rehabilitation. Their commitment to eliminating transfers to the public enterprises and to closing nonviable public enterprises was welcome. They should also take further steps toward transferring enterprises to the private sector.

The debt service burden was large for a country in Guinea's stage of development, Ms. Lundsager considered. The debt service ratio had exceeded 21 percent thus far in 1984, and the authorities' intention to avoid contracting additional nonconcessional debt was appropriate. They should be urged to formulate a plan for reducing external arrears to improve the country's credit rating.

Guinea had made a number of improvements in economic management, Ms. Lundsager concluded, but its external situation was serious and required immediate remedial action. Additional strong efforts were required to contain aggregate demand and raise domestic production. Those steps, together with continued reforms in the public sector, would encourage the international community to provide the increased support--including foreign investment--that the authorities sought. The proposed decision should be approved.

Mr. Joyce commented that the recently announced policy initiatives were encouraging. He agreed with the staff that the economy had considerable potential--particularly in agriculture and mining--and that a dramatic shift in policy was needed to exploit it. The authorities apparently were prepared to reduce the distortions in the economy, allow market forces a greater role in encouraging production and allocating resources, and restore to the economic mainstream the activities and ingenuity that had been channeled largely toward parallel markets. Their new policy stance was commendable, and he hoped that the ongoing discussions involving the authorities, the Fund, the World Bank, and bilateral creditors would provide the foundation for a realistic adjustment program and its financing.

The authorities had indicated that they intended to formulate a comprehensive adjustment program but wished to secure adequate external financing before taking certain policy initiatives, such as realigning the exchange rate and liberalizing the trade and payments system, Mr. Joyce commented. While he fully agreed that a coherent and comprehensive development strategy was necessary, and while he understood the authorities' wish to proceed cautiously, certain steps should be taken forthwith, as they would provide immediate benefits. In particular, a realistic exchange rate and increases in prices of inputs and prices paid to producers of export crops would spur export production, improve profitability, and strengthen the balance of payments.

He strongly supported the staff's recommendation to provide technical assistance to help the authorities to design an adjustment program and improve the data base, Mr. Joyce remarked. He hoped that both the Fund and the World Bank would contribute to that effort.

Mr. Grosche said that the reorientation of policy toward market-oriented mechanisms was a welcome break with the past trends of highly centralized planning, unrealistic exchange rates, and inappropriate producer prices that had caused serious inefficiencies. However, he agreed with the staff and previous speakers that, unless the authorities implemented the necessary measures quickly and with determination, progress would be slow, and the aspirations of the Guinean people would not be met. The indications that the authorities were ready to consider taking bold steps were welcome. Given the sizable structural imbalances, the highly unrealistic exchange rate, and the excessively complex exchange and trade system, a piecemeal policy approach would be inadequate. Only decisive changes in policies and, where necessary, in the institutional structure would enable Guinea to make full use of its vast resources.

In fiscal policy, Mr. Grosche commented, a thorough rehabilitation of the public enterprise sector was a prerequisite for a viable policy stance, as transfers to those enterprises had been the major cause of the deterioration in public finances during the previous several years. He wondered whether the study of the overall operations of public enterprises that was nearing completion had been undertaken in cooperation with the World Bank or some other development agency. He fully agreed with the staff that a fundamental review of the tax structure was also called for; indeed, it should be undertaken forthwith. A reform of the tax structure should make an important contribution both to improving the overall efficiency of the economy and to reintegrating the underground economy into the rest of the economy.

The beneficial effect of a tax reform would be enhanced by an adequate pricing policy, particularly for the agricultural sector, Mr. Grosche continued. In the past, a misguided pricing policy had adversely affected that sector, which had produced exportable surpluses in earlier years but was operating far below potential. The structural adjustment effort must include a depreciation of the highly overvalued exchange rate followed by the introduction of a flexible exchange rate policy designed to maintain competitiveness.

The recent closing of the state trading enterprise was welcome, but apparently it had not created more room for private sector trade, as the enterprise's responsibilities had been assumed by the Ministry of Foreign Trade, Mr. Grosche remarked. The continued existence of the highly restrictive exchange and trade system was also regrettable. The inefficiency that it caused was obvious, and it had not prevented either the accumulation of large arrears or the continued existence of substantial external imbalances.

Major policy changes would help restore the confidence of creditors and aid donors, Mr. Grosche commented. An increase in confidence was essential to Guinea's multilateral rescheduling exercise. Guinea's difficult external situation had been compounded by the large payments arrears, and a prudent debt policy was clearly advisable. Debt should be contracted only for investments that would quickly increase the country's debt servicing capability.

As the staff and previous speakers had stressed, the coverage, currentness, and reporting of statistical data in Guinea should be substantially improved, Mr. Grosche said. Fund technical assistance could be most beneficial, and the staff's statement on the assistance that had already been provided and could be given in the future was welcome. Finally, the proposed decision was acceptable.

Mr. Zhang said that he was pleased that the authorities had decided to undertake a comprehensive adjustment program, and that they intended to request technical assistance from international institutions, particularly the Fund and the World Bank.

Mr. Kabbaj stated that he agreed with the staff appraisal and accepted the proposed decision.

The staff representative from the African Department said that one of the purposes of the present World Bank mission to Guinea was to determine how the World Bank could assist the country in the immediate future. The World Bank staff hoped to be able to help the authorities to eliminate the structural bottlenecks impeding growth and production, particularly in the transportation, industrial, and agricultural sectors. A number of feeder roads were needed to bring to market the agricultural surplus that the authorities hoped to generate with their new policy stance. One of the main problems in the industrial sector was the lack of a regular supply of electricity; the World Bank was assisting in improving the situation. It was also investigating the possibility of making available a Rehabilitation Import Credit in 1985, provided that a Fund-supported program was in place.

Many of the approximately 150 public enterprises in Guinea were inefficient, the staff representative remarked. The authorities had nearly completed a study of the public enterprise sector, and the World Bank had contributed to it by providing recommendations concerning some of the key enterprises, particularly the Electricity Supply Corporation.

The state trading agency, IMPORTEX, had been abolished, but its functions had been assumed temporarily by the Ministry of Foreign Trade, the staff representative from the African Department explained. It was the staff's understanding that the authorities intended eventually to divest the Ministry of Foreign Trade of those functions, but no concrete steps in that direction had yet been taken, although the staff had recommended early action.

Mr. Sangare said that it was important to stress that the authorities would need the support of the international community in their efforts to solve the problems that had faced the economy for a number of years. The authorities were fully prepared to cooperate with the Fund in finding appropriate solutions to their payments problems.

The Chairman made the following summing up:

> Directors were in broad agreement with the views expressed in the staff appraisal. They expressed their serious concern about the disappointing performance of the Guinean economy and the large internal and external imbalances that had built up over a number of years, in sharp contrast with Guinea's considerable economic potential in agriculture and in mining.
>
> The change in policy orientation announced by the new Guinean authorities was warmly welcomed by Directors. In particular, the decision in principle to allow market forces to play a greater role in the allocation of resources was seen to

be a very positive step. In commenting on this decision, Directors urged the authorities to implement the change in policy orientation promptly, and they emphasized that the liberalization of economic activity should stimulate a rapid recovery in productive activity in the key sectors, notably food production.

While noting that a number of corrective actions had already been taken, Directors stressed that a comprehensive adjustment program was clearly required. They expressed the hope that such a program could be worked out and implemented with Fund assistance as soon as feasible. The central element of such a program would be a major exchange rate adjustment and the introduction of a unitary exchange rate system that would reflect market realities, coupled with a liberalization of the exchange and trade system. In order to stimulate agricultural production, the benefits of the exchange rate action would have to be passed through to producers, and appropriate price incentives for production and exports should be introduced and maintained. It would also be important that fiscal policy be restrained during the adjustment period. In this connection, the need for a major tax reform and the importance of containing government transfers to the public enterprises were underscored. Regarding the public enterprise sector, it was noted that vigorous action was required to eliminate nonviable units, and that decisive corrective measures would have to be taken urgently to improve the financial position of those units that would continue to operate. As to monetary policy, Directors agreed on the need to integrate the private sector into the banking system to channel financial resources to the productive sectors, and on the need to adopt a realistic interest rate policy.

Guinea's fragile external position was of particular concern to Directors, who indicated that, in support of the required decisive internal adjustment measures, Guinea would need considerable external financial assistance in the period ahead, including appropriate debt relief. In this connection, the decision of the Guinean authorities to follow a multilateral approach was endorsed. Directors urged Guinea to eliminate external payments arrears as soon as possible.

Directors noted that, while the immediate stabilization issues were being addressed, it would also be important for the authorities to elaborate a coherent development strategy. They welcomed the early involvement of the World Bank in helping the authorities to establish appropriate investment priorities and to identify and remove obstacles inhibiting the effective exploitation of the country's considerable resources. The preparation of a new liberal investment code was also welcomed. Expanded technical and financial support from the World Bank was seen as an indispensable element in the medium-term rehabilitation of the Guinean economy.

Directors noted the serious problems posed by the weak statistical base in Guinea and welcomed the expanded technical assistance made available by the Fund to enable the authorities to bring about the needed improvements quickly. It was hoped that additional assistance would be forthcoming promptly from bilateral and multilateral sources, and that it would be appropriately coordinated.

It is expected that the next Article IV consultation with Guinea will take place on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Guinea in the light of the 1984 Article IV consultation with Guinea conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Guinea continues to maintain a number of restrictive exchange practices as described in SM/84/226. While welcoming the progress made in Guinea in the pursuit of a liberalization policy, the Fund urges the authorities to take early comprehensive action to correct the distortions in costs and prices in the Guinean economy and to accelerate progress in eliminating restrictive practices, including the external payments arrears and the bilateral payments agreements with Fund members.

Decision No. 7831-(84/159), adopted
October 31, 1984

2. NICARAGUA - OVERDUE FINANCIAL OBLIGATIONS

The Chairman recalled that Executive Directors had been informed in EBS/84/48, Supplement 3 (9/5/84) that the Nicaraguan authorities had expected to explain their specific plans for settling Nicaragua's overdue financial obligations to the Fund during the 1984 Annual Meetings, or shortly thereafter, and that management had intended to provide a further report to the Executive Board in October on the basis of that explanation. It had not been possible to hold those tentatively scheduled meetings, but another meeting had recently been scheduled for November 13, 1984. He had stressed to the Nicaraguan authorities the importance the Fund attached to the problem of overdue financial obligations and had informed them of his hope that, as a result of the coming meeting, he would be able to report to the Executive Board that the overdue obligations would be settled promptly. In any event, the Executive Board would receive a report soon after the November 13 meeting.

The Executive Directors noted the Chairman's statement.

3. EXECUTIVE DIRECTORS

The Chairman bade farewell to Mr. Donoso, Mr. Sangare, Mr. Senior, Mr. Feito, Mr. Morrell, and Mr. Teijeiro upon the completion of their service on the Executive Board.

APPROVED: July 26, 1985

LEO VAN HOUTVEN
Secretary