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Minutes of Executive Board Meeting 84/141

10:15 a.m., September 12, 1984

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

Executive Directors	Alternate Executive Directors
A. Alfidja	w. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	C. Flamant, Temporary
	M. A. Weitz, Temporary
	M. K. Bush
	M. Lundsager, Temporary
	M. Z. M. Qureshi, Temporary
H. Fujino	T. Yamashita
G. Grosche	D. Hammann, Temporary
J. E. Ismael	
R. K. Joyce	
	C. Robalino
	N. Coumbis
	A. S. Jayawardena
	S. El-Khouri, Temporary
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
F. Sangare	M. Camara, Temporary
	E. Portas, Temporary
	A. Lindø
	T. A. Clark
Zhang Z.	

L. Van Houtven, Secretary
S. L. Yeager, Assistant

Also Present

African Department: J. B. Zulu, Director; L. M. Goreux, Deputy Director; P. Beaugrand, E. L. Bornemann, E. A. Calamitsis, C. V. Callender, R. O. Carstens, F. d'A. Collings, S. E. Cronquist, A. B. Diao, I. A. H. Diogo, M. E. Edo, M. G. Gilman, U. R. Gunjal, J. Kakoza, H. R. Lorie, T. Oyama. European Department: L. A. Whittome, Counsellor and Director. Exchange and Trade Relations Department: E. H. Brau, L. H. Duran-Downing, S. Kanesa-Thasan, E. B. Maciejewski, J. Schucht, N. E. Weerasinghe. Fiscal Affairs Department: R. J. Hurnard, A. Tazi. IMF Institute: J. Bro Grebe, Participant. Legal Department: W. E. Holder, A. O. Liuksila, J. K. Oh. Research Department: L. Alexander. Treasurer's Department: D. Williams, Deputy Treasurer. Bureau of Statistics: K. Yao. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, S. M. Hassan, H.-S. Lee, G. E. L. Nguyen, D. I. S. Shaw. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, R. L. Bernardo, J. Bulloch, L. E. J. M. Coene, N. Haque, S. Kolb, A. Koné, J. A. K. Munthali, K. Murakami, E. Olsen, G. W. K. Pickering, D. J. Robinson, A. A. Scholten, Shao Z., A. Yasseri.

1. IVORY COAST - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report on the first review of the one-year stand-by arrangement for Ivory Coast (EBS/84/161, 8/1/84), approved in principle on May 2, 1984 (EBM/84/71, 5/2/84) in an amount equivalent to SDR 82.75 million, and which became effective on August 3, 1984.

The Deputy Director of the African Department, referring to the conditions for the entry into effect of the arrangement, reported that a CFAF 18 billion adjustment loan from the Caisse Centrale de Coopération Economique for financing the uncovered balance of payments gap for 1984, described in EBS/84/81, Supplement 3 (7/31/84), had been formally approved, and the likely disbursement of CFAF 10 billion in 1984 had been confirmed.

The preliminary data presented in the paper before the Board, which indicated that the performance criteria for end-June would have been satisfied apart from the ceiling on public sector arrears, had also been recently confirmed. The excess of arrears was fully explained by the combination of delays in disbursements of balance of payments loans and lower than programmed use of domestic credit by the public sector. With the release of the second tranche of a World Bank structural adjustment loan in late July and the stand-by purchase from the Fund in early August, Ivory Coast had been able to reduce external arrears from CFAF 37 billion at end-June to about CFAF 16 billion as of September 10 and to start clearing up the intricate payments arrears situation in the energy sector. Also, bridge loans for the oil refinery and the electricity company no longer seemed to be required.

The overall response of commercial banks to the proposal contained in the Steering Committee's protocol, signed on July 27, 1984, had been satisfactory, the Deputy Director added, but some delay had occurred in finalizing various legal documents which were expected to be submitted to the Ivorian authorities not earlier than October; consequently, the first tranche (CFAF 37.5 billion) of a CFAF 50 billion balance of payments loan was likely to be disbursed only toward the end of 1984. Bilateral negotiations with Paris Club creditors were progressing satisfactorily, and agreements had already been signed with the Swiss and French Governments which covered over half the debt to be rescheduled by the Club. Negotiations with creditors not represented in the Paris or London Clubs were being conducted in the so-called Club d'Abidjan, which had met in August and was expected to meet again shortly. Moreover, the uncertainties expressed in the staff paper concerning Air Afrique's ability to service its external debt seemed to have been subsequently resolved; shareholder governments had repaid their arrears to the company, thus enabling Air Afrique to service its debt in the months ahead.

The target for transfers from the Stabilization Fund to the Treasury in the second half of 1984 had been CFAF 60 billion, of which CFAF 22 billion was to have been transferred in the third quarter, the Deputy Director noted. Since August 1, CFAF 11 billion had been transferred, including CFAF 6 billion that morning. The staff remained in close contact with the authorities regarding the transfer of the remaining CFAF 11 billion before the end of September. Concerning measures to reduce public expenditures, the decree on scholarships had been issued on August 22 and the modalities for its application were being finalized; the number of new scholarships would be substantially reduced by restricting them to candidates with both financial need and good academic records. Following the reduction in the number of expatriates employed under technical assistance programs, the authorities had also decided to reduce sharply the government hiring of expatriates from private consulting firms starting from January 1985.

Two consulting firms had been appointed to conduct a technical and financial study of the oil refinery, with the understanding that the study would be completed in four months, the Deputy Director added. The Ivorian authorities had also requested the stationing of a Fund resident representative in Abidjan shortly after the Annual Meetings.

Finally, in page 5 of the staff paper it was stated that the total staff of SODESUCRE had been reduced to 6,000, while the figure of 7,000 was given in page 10 of the letter of intent, the Deputy Director of the African Department observed; he had been informed from Abidjan that the exact number was 6,430.

Mr. Alfidja made the following statement:

> The staff report on the first review of the stand-by arrangement, which was approved in principle by the Executive Board on May 2, 1984 and became effective on August 3, 1984, gives a clear indication that the Ivorian authorities are making satisfactory progress in their efforts to correct the internal and external imbalances that characterized the country's economy. It is encouraging to note that all performance criteria for end-March 1984 were met with some margin. Preliminary data also show that the performance criteria for end-June 1984 would be observed, except for the ceiling on public sector payment arrears, the causes of which have been fully explained in the staff report and were largely beyond the control of the authorities.
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> Developments in the agricultural sector are expected to be the principal driving force behind the country's recovery program. However, unfavorable weather conditions have adversely affected the production of coffee for the 1983/84 crop year. Coupled with other factors, such as the shortage of electricity supply and further cutbacks in the public investment program, overall economic activity has slowed down and real GDP is expected to decline for the third consecutive year. However, the various producer price incentives granted to farmers, together with favorable weather conditions, should boost agricultural production during the 1984/85 crop season. In fact improved weather conditions during the first half of 1984 have contributed to a

better supply situation for locally produced foodstuffs, thereby helping to contain the rise in the cost of living index. To encourage private investment and promote exports, the authorities have approved a new investment code, revised the tariff system and quantitative import restrictions, and established a subsidy scheme for selected manufactured products for export.

In my last statement of May 2, 1984, I mentioned that the restoration of viability in the public sector was crucially dependent on the restructuring of the public enterprise sector. In this connection, my authorities have successfully implemented measures to rehabilitate many public enterprises. Two of the six sugar complexes have been shut down. A rehabilitation program with the assistance of the World Bank and the Caisse Centrale de Coopération Economique (CCCE) is about to be completed for the four remaining complexes. Concerning the electricity company (EECI), the authorities have adopted measures to conserve electricity consumption in both the public and private sectors, under an energy conservation program for which external assistance is being sought. Measures to reduce operating costs have also been taken in order to arrest a further deterioration in the finances of the oil refinery (SIR), and a World Bank financed in-depth management audit of this enterprise is to be completed before the end of the year. The Ivorian authorities are proceeding with rehabilitation measures together with the governments and lenders involved in the financing and operations of the multinational firms, CIMAO, RAN, and Air Afrique, in order to resolve their mounting financial and managerial problems.

In the fiscal sector, the authorities have succeeded in achieving a substantial adjustment, compared with the financial situation in 1983. These favorable financial developments mainly reflect the austerity measures introduced by the authorities and the effects of the rehabilitation programs initiated by the public enterprises. Following their commitment to freeze total expenditure, all discretionary outlays are subject to restraint. However, on account of higher interest payments on the external debt, owing to the recent rise in interest rates and the appreciation of the U.S. dollar, current expenditure will show a slight increase.

Developments in the area of money and credit during the first six months of 1984 were largely influenced by several factors, including in particular the shortfall in the disbursements from the loans earmarked for balance of payments support and the delays in drawing from the Fund. Another contributory factor to the tight liquidity position of the banking system was the noncommittal position adopted by lenders pending the completion of the debt rescheduling negotiations. The authorities have taken the necessary steps to monitor the activities of banks to ensure their competitiveness, and promote investment in small and medium-size enterprises.

The external sector position remained under pressure during the first half of 1984. Higher coffee and cocoa export receipts and the effect of a cutback in imports for public investment were expected to bring about an improvement in the current account deficit. The Ivorian authorities are concerned that despite their strong adjustment efforts, increased external financial support has been slow in materializing. It is encouraging that on July 27, 1984 the Steering Committee of the commercial banks agreed not only to reschedule the Ivorian external debts due to them, but also extended a new loan of CFAF 50 billion for balance of payments support.

In concluding, I wish to emphasize that the satisfactory results achieved so far demonstrate clearly the strength of the adjustment efforts that have been taken in the context of a difficult economic environment, especially the severe drought of 1983, coupled with the rapid increase in interest rates and the value of the U.S. dollar, resulting in higher than expected interest payments. The difficulties that the authorities encountered during the beginning of the year have strengthened them in their determination to pursue their policies which will eventually bring about the recovery in the economy. I therefore urge the Executive Board to adopt the proposed decision.

Mr. Blandin observed that the staff report fully demonstrated that in 1984 Ivory Coast had continued the strenuous adjustment efforts which it had begun in 1981 and which had first been supported by an extended arrangement with the Fund. The results of those efforts had been delayed, not only because of the worsening external environment, marked in particular by the deterioration in the terms of trade and the severe drought of the previous year, but also because of the time required to reverse the adverse consequences of the misallocation of resources in preceding years. With their intensification in 1984, the adjustment efforts were beginning to pay off, and the financial targets of the program presently appeared to be attainable. Moreover, a number of recently introduced financial measures should play an important role in helping the country regain its momentum toward a more balanced and sustainable economic growth in the long run.

The programmed reduction in the fiscal deficit for 1984, which would amount to 6.5 percentage points of GDP, was impressive, Mr. Blandin continued. The reduction would be attained primarily through an increase in revenues, which had grown by one third over the past two years and currently represented 31 percent of GDP. The sizable increase in revenues would result from transfers from the Stabilization Fund, which had benefited in 1984 from the long overdue reversal in the terms of trade and the appreciation of the U.S. dollar vis-à-vis the CFA franc. As for the reduction in public expenditure, the authorities were to be commended for holding a tight rein on personnel expenditures, which had declined by nearly 6 percent in real terms over the past two years. The increase in interest rate payments, which had been estimated at CFAF 256 billion and were currently forecast to amount to CFAF 275 billion--exceeding personnel expenditure--was the essential reason for the overshooting in current expenditures. That increase represented more than half the total amount of the stand-by purchase. It was disheartening that the adjustment efforts of Ivory Coast were jeopardized by the rise in interest rates that had occurred since the beginning of the year and that seemed to illustrate the negative impact of higher interest rates on developing countries. Lower interest payments would have allowed for higher repayments of domestic arrears and have been helpful to the private sector, which had suffered a severe liquidity squeeze as a consequence of those arrears.

The reduction of the current account deficit to only 7 percent of GDP was the logical outcome of fiscal and monetary discipline, Mr. Blandin remarked. It was nevertheless particularly encouraging to observe that the medium-term projections for the balance of payments presented in Table 5 of the staff report indicated that the current account would improve in coming years and that quasi-equilibrium should be achieved within the next four years. It was also noteworthy that Ivory Coast had been the first African country to get fresh money in the context of rescheduling with commercial banks, despite the fact that nearly 40 percent of the fresh money would be pre-empted by the CFAF 19 billion increase in interest rates.

Progress in structural reform might be even more encouraging in the long run than the good financial results already achieved, Mr. Blandin noted. Reform had accelerated in 1984, notably as the consequence of the implementation of the structural adjustment loans extended by the World Bank and the Caisse Centrale de Coopération Economique. The measures that had been enforced demonstrated once more the importance of the close cooperation between the Fund and the Bank, which in the case of Ivory Coast had proven excellent. The Fund mission had benefited greatly from the regular participation of a World Bank expert.

The efficiency of the productive sector had also improved, Mr. Blandin observed. Producer prices had been increased for many agricultural products and should provide better incentives to farmers. The public enterprise sector, which had been overextended during the years of the commodity boom and had become an unsustainable burden on public finances, had been consistently streamlined. The sharp decline in the public investment program should be analyzed in that context; to the extent that the remaining investments were concentrated on productive and profitable activities, that decline should not hamper the resumption of economic growth. The adoption of the new investment code and the new tariff system were also steps in the right direction and would improve resource allocation through an increased role for the private sector. The pursuit and, if needed, the intensification of the structural adjustment program appeared to be the only way toward the resumption of the sustained growth of per capita incomes in Ivory Coast.

He supported the proposed decision and welcomed in particular the change in the schedule of purchases, which went in the direction of the request that he had made on the occasion of the Board's last discussion of the arrangement, Mr. Blandin remarked. Technically, the use of Fund resources would amount to 67 percent of quota a year; while that increase could be viewed as purely an optical illusion, it nevertheless led him to conclude that he had been correct in saying that the amount of Ivory Coast's access to Fund resources in the past had been unduly limited.

Mr. Camara stated that the Ivorian authorities appeared to be committed to the program and seemed to be doing what was necessary to keep it on track. The slippages that had emerged were unavoidable, and he therefore supported the amendments to the performance criteria contained in the proposed decision.

The adjustments in the budget had been substantial, Mr. Camara noted; the deficit was expected to drop to the equivalent of about 4 percent of GDP in 1984 from over 10 percent in 1983, despite the shortfall in revenue. That reduction reflected the serious efforts that were being made to contain expenditure. Even with the many cost-reducing measures, current expenditure had been augmented to meet higher interest payments on external debt resulting from rising interest rates; that had placed a greater burden on the capital budget, which had declined by CFAF 21 billion. Although the overall target for reducing the public sector deficit was being attained, the expenditure mix might hamper the long-term growth prospects of the economy, which would have registered four consecutive years of negative growth in real GDP by the end of 1984. Although the authorities were taking steps to improve the performance of public corporations, it seemed that the task was not yet completed, especially with regard to the sugar industry and the oil refinery, whose deficit was presently nearly as large as that of the sugar corporation.

Ivory Coast had not yet passed the import compression stage in its adjustment efforts, Mr. Camara remarked. As he had observed during the Board's discussion of the world economic outlook, a number of African countries found themselves in that predicament despite the general recovery in the world economy. Higher interest payments were also coming at an inopportune time for Ivory Coast--namely, when export earnings were expected to be lower than initially envisaged--resulting in a debt service ratio of 22.7 percent even after rescheduling. The debt service would remain a burden on the Ivorian economy for some time, with an average debt service ratio in excess of 37 percent projected for the period 1985-90. The heavy debt burden was likely to have adverse consequences on living standards over the medium term. The staff had alluded in page 15 of its report to a grim situation: "the less favorable external environment needs to be offset by stronger adjustment measures in order to avoid deterioration of the debt service ratio in 1990, and, under such conditions, Ivory Coast could probably only aim at avoiding a decline in real per capita income." That statement pointed to the need for the authorities to continue their current prudent policy in order to lay the foundation for sustained economic growth.

Mr. Schneider stated that Ivory Coast had made the necessary efforts to satisfy the prerequisites for the activation of its stand-by arrangement and had also succeeded in meeting the end-March performance criteria. The end-June criteria had also been observed, with the exception of the ceiling on public sector payment arrears. That nonobservance seemed attributable to factors beyond the direct control of the authorities--namely, delays in expected disbursements of World Bank structural adjustment loans and Fund purchases under the present stand-by arrangement. Since external financing had been secured, the rephasing of purchases was indeed an appropriate response to that sort of nonobservance, and since the proposed modifications of the upcoming performance criteria did not weaken the program, he was able to agree with the proposed decision.

Prospects for achieving the main objectives of the program were encouraging, Mr. Schneider remarked. It was very likely that the targets of reducing the current account deficit from 10 percent of GDP in 1983 to 7 percent in 1984, and reducing the public sector deficit from 10 percent of GDP in 1983 to 4 percent in 1984, would be attained. The package of measures for readjusting the economy was appropriately designed to meet those objectives. In the agricultural sector, the rise in producer prices, combined with the expectation of higher output based on better weather conditions in 1984, should improve the supply of domestic foodstuffs and increase export earnings. Measures entering into effect in October aimed at promoting private investment and better resource allocation were also prudently designed to complement the adjustment program over the medium term.

In spite of the great efforts made by the authorities, two areas continued to require very close attention: public finances, especially the public sector enterprises, and the new threat posed by the difficulties of the banking sector, Mr. Schneider went on. Public expenditures had been sharply curtailed by a decrease in public investment and progress had also been made in limiting public sector employment, lowering the cost of education, and reducing the number of expatriates. Unfortunately the benefits of those changes had been partly offset by higher interest payments on the external debt. Moreover, expectations were strong that interest rates would rise further and probably continue to affect public finances and the balance of payments. In addition, economic policy actions on the external side were hindered by the country's participation in the West African Currency Union; that had also had a certain negative effect on the debt service ratio, which would remain rather high in the medium term even after rescheduling.

Nonetheless, the vigor with which the authorities were tackling the restructuring of the public sector enterprises was encouraging, Mr. Schneider remarked. Most of those enterprises covered an entire sector of the economy, for example, sugar production or oil refining. Their restructuring was therefore crucially important to the economy as a whole, and it was vital that the reduction of their deficits should be accompanied by effective rehabilitation programs. It would generally be necessary to concentrate on innovative new investments to provide industry with comparative advantages, and he welcomed the complementary assistance of the World Bank in that area.

The difficulties of the banking sector posed a new threat to the successful completion of the present program, Mr. Schneider noted. The solvency problems of major and smaller banks might eventually require a government rescue operation. Since the problems were not only the result of the protracted recession but also of poor management and accounting practices, it was urgent that the Central Bank strengthen its supervision of those banks. In that context, he welcomed the stationing of a resident Fund advisor in Abidjan.

The measures taken thus far were well conceived for the successful completion of the program, Mr. Schneider concluded. The Ivory Coast authorities were to be commended for their great efforts, which must not cease after completion of the program, however. Close attention would need to be given to the supply side of the economy both to improve the allocation of resources through new investments and to strengthen the country's competitive advantage.

Mr. Clark remarked that while he could support the proposed decision including the rephasing of drawings and the shortening of the duration of the arrangement, he remained concerned about the general lack of synchronization between the period of Fund arrangements and the period of the policy programs which they were intended to support. When the coming into effect of an arrangement was delayed, it might not always be appropriate simply to compress the drawings, and it might not be appropriate, or consistent, to maintain the original level of access. In the case of Ivory Coast, a program originally pitched at 50 percent of quota was at present effectively equivalent to 67 percent of quota. He looked forward to the opportunity of discussing those and related matters when the Board considered the paper on "Approval in Principle of Fund Arrangements."

He was curious about the nature of the second review of the program, Mr. Clark continued. The final sentence of the letter of intent, dated July 27, 1984, stated that, "the authorities will review the progress of the program with Fund staff in November and will consult the Fund if necessary in accordance with Fund practice in this area." He requested staff clarification, first, on whether the review would involve a Board discussion, and second, on the main items to be discussed with the authorities during the review.

He welcomed the inclusion of the medium-term fiscal projections given in Table 5 on page 13 of the staff report; that technique could usefully be adopted for other cases, Mr. Clark added. In future staff reports on Ivory Coast, he hoped the staff could include a line expressing debt service in the medium term as a percentage of fiscal revenue in one of the tables. The inclusion of as much information as possible on the finances of individual parastatal enterprises would also be helpful, since they accounted for the entire deficit of the consolidated public sector.

Although substantial adjustment had been achieved on the fiscal side, several questions concerning policy remained, Mr. Clark noted. First, two revenue measures envisaged under the program had not been implemented, namely, the tax on equipment and the embarkation tax, and 80 percent of the anticipated revenue yield of those measures was presently expected to have to come from other sources. What were the authorities' current plans with respect to the implementation of those two taxes? Second, he shared the staff's concern about the situation of five smaller banks in Ivory Coast and wondered what provision existed for prudential supervision of local banks and to what extent it involved the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO). Third, the staff paper on the effective date of the stand-by arrangement (EBS/84/81, Sup. 3) had noted, in connection with the commercial banks' rescheduling, that the Steering Committee had agreed to lend new money. The disbursement of the new money would be important both in relation to the end-September performance criterion for the cash reduction of arrears and for the authorities' plans for improving the financial situation of the energy sector. In view of the large number of banks involved--the Steering Committee represented about 350 institutions--did the staff envisage any delays in disbursement? Fourth, developments in Ivory Coast's oil industry had important implications for the balance of payments. Among the assumptions underlying the medium-term outlook given in Table V on page 40, were figures for crude oil production to 1988; what did those figures imply for Ivory Coast's trade balance in oil?

In concluding, Mr. Clark commended the authorities for the success of the program to date and encouraged them to persevere in their adjustment efforts.

Ms. Bush stated that the first review of the Ivory Coast stand-by arrangement indicated that the program was on track. The previously projected balance of payments gap was presently closed, with internal adjustment and external assistance sufficient to permit the elimination of external arrears and a substantial reduction in internal arrears. The increase in the budget deficit target to 3.9 percent of GDP was acceptable, since the improvement over 1983, when the deficit to GDP ratio was 10.4 percent, was still quite substantial. Also, the downwardly revised revenue figures resulted from the lower than expected rate of real economic growth for 1984. However, it was noteworthy that development expenditures were bearing the brunt of the additional adjustment. While it was necessary to set realistic development priorities and expenditure levels, it was also necessary for Ivory Coast to resume building a base for future economic growth and development. The authorities should therefore examine current expenditures more carefully, especially in the parastatal sector, to determine if more savings were possible in that sector.

Regarding the parastatals, Ms. Bush recalled that during the Board's discussion of the program in May, she had suggested that an expanded role for the private sector in those areas at present exclusively under government control might be one method of generating increases in efficiency and thus reducing the burden of those enterprises on the budget; it might also result in a restructuring of the economy, with resources flowing into those sectors that could be internationally competitive. While the staff paper indicated that efficiency in the parastatals was improving, she continued to urge an expanded role for the private sector.

She was concerned about the use of export subsidies to offset import tariffs in order to maintain export competitiveness and was somewhat puzzled about the rationale and the lack of competitiveness of Ivorian products that it implied, Ms. Bush remarked. Given the real effective depreciation of the CFA franc shown in Chart 1 on page 10a, further incentives to exporters did not appear to be necessary. During the Board's last discussion of Ivory Coast, the export subsidy policy had been questioned, although the World Bank had been requiring it for the release of the second tranche of the structural adjustment loan; closer Bank/Fund coordination seemed to be indicated in that area.

On procedural issues, Ms. Bush noted first, that the final purchase under the stand-by arrangement was at present conditional on Ivory Coast meeting the end-December performance criteria, thus extending the Fund's monitoring role under the program--a point which her chair had emphasized at the time the program had been approved. Second, if the Fund was to support a new program for 1985 and 1986, the purchases should be appropriately phased to avoid unnecessary front-loading. Third, like Mr. Clark, she was concerned about the timing problems when there was a long lag between the approval of an arrangement and the implementation of the program; she invited staff comment on the procedures to be followed in such cases.

Mr. Joyce recalled that he had supported the proposed objectives as well as the program enshrined in the one-year stand-by arrangement when it had been discussed by the Board in May (EBM/84/70 and EBM/84/71, 5/2/84). He noted with satisfaction that the improvements envisaged in the financial position of the public sector and in the balance of payments position for the first part of the program had been largely achieved. Despite some delays attributable to uncertainties about how the financing gap for 1984 was to be met and the implementation of some prior fiscal actions, as well as a breach in the performance criterion at end-June with respect to arrears, Ivory Coast had met all other criteria for mid-March comfortably and appeared also to have fulfilled the rest of the criteria for end-June. The failure to meet the performance criterion on net domestic arrears could be attributed to domestic liquidity problems linked to the shortfall in disbursements from the World Bank and the delay in access to the Fund's resources. Therefore, he agreed with the staff that the program was basically on track and that it seemed reasonable to approve some modification of the arrears targets and the phasing of drawings for the future.

The program deserved continued Fund support for several reasons, Mr. Joyce continued. First, the authorities had taken some important steps to reduce public sector financial imbalances during the first half of 1984. The drought during 1983 had made that all the more difficult to accomplish. Nevertheless, most of the envisaged tax measures had been implemented, and most of the discretionary tightening in government expenditures had been undertaken as expected. Furthermore, capital expenditure had been reduced and would remain very modest. As Mr. Alfidja had noted in his opening remarks, the reduction of expenditures represented a substantial adjustment. Second, the steps taken to reduce the deficits from the public enterprises were already beginning to bear fruit; the financing requirements of those enterprises and their pull on the budget was beginning to decline. Third, the authorities had negotiated a rescheduling of the public and private external debt, and the medium-term balance of payments position, although still very uncertain, could become sustainable if the economic policy adjustments were continued and if external creditors continued to support Ivory Coast's efforts. For those reasons he supported the program and accepted the staff's recommendations.

Three areas of concern remained, Mr. Joyce added. The financial difficulties of the public enterprises had not yet been resolved. Assistance from the World Bank would be important, but would need to be supported by further concrete policy actions by the authorities. The financial position of five smaller banks in Ivory Coast gave rise to grave concern. The authorities should strengthen the Central Bank's supervision of those banks, and he would support any technical assistance that the Fund might be able to provide in that area. The data in Table 6 indicated that the external debt position of Ivory Coast also continued to be a matter of serious concern. The debt service ratio was to remain close to 40 percent through the rest of the decade, which underscored the need to intensify the adjustment effort through the remainder of 1984 and to continue to do so for several years.

He could accept the proposal by the Minister of Economy and Finance to modify the phasing of the last two purchases, Mr. Joyce remarked. The original phasing had been complicated by the delays in taking prior action; the revised phasing represented a strengthening of the program because the final purchase in March 1985 would be linked to observance of the end-December performance criteria, which had not originally been the case. He further noted that since the program would run for 9 months rather than 12, as originally envisaged, Ivory Coast's use of Fund resources, on an annual basis, would reach 67 percent of quota, which, in the circumstances, did not seem excessive.

Mr. Grosche stated that he was in broad agreement with the staff appraisal and supported the proposed decision. Performance under the program, especially in the fiscal area, was noteworthy. The reduction in the public sector deficit was remarkable and was evidence of a high degree of commitment. The improvement had been brought about by a reduction in capital expenditure and by the increased contribution of the Stabilization

Fund. It might be appropriate in future papers to include all the operations of that agency in the general government budget. Currently, it was not clear whether the increased contribution by the Stabilization Fund stemmed from higher revenues or lower expenditures--the latter in the form of reduced compensation for farmers and other expenditure items; he invited staff comment on that point. Like Ms. Bush, he considered that future budgetary cuts should focus more on current rather than capital expenditure. In financing the balance of payments gap, Ivory Coast had not only reached favorable results in the rescheduling negotiations, but had also been able to obtain fresh money. That was a hopeful sign, especially considering Ivory Coast's relatively large use of Fund resources and possible constraints on future access.

Two aspects of the program raised questions, Mr. Grosche continued. First, one performance criterion had not been met at the end of June. While he was grateful for the additional explanation given by the Deputy Director of the African Department, he still failed to understand fully what had happened. The explanation on page 18 of the staff report, which differed from that given on page 2, conveyed the impression that the failure to meet the public sector arrears target had been due to the delayed drawings under the stand-by arrangement. But drawings from the Fund were contingent upon the fulfillment of certain other conditions, and the Fund could not be blamed if necessary measures had not been fully implemented or if the gap in the balance of payments had not been filled in time.

Second, the shortening of the program period raised Ivory Coast's access to Fund resources in terms of quota, Mr. Grosche went on. The staff had justified that outcome by noting that the effective adjustment period had begun as envisaged in early 1984. Like Mr. Clark, he was nonetheless concerned and would like the general aspects of the Ivory Coast case to be dealt with in the forthcoming paper on the approval in principle of stand-by and extended arrangements.

Mr. Salehkhou expressed his broad concurrence with the thrust of the staff appraisal and his support for the proposed decision, including the request by the Ivorian authorities for changes in the original performance criteria. The nonobservance of the performance criterion related to public sector payments arrears at the end of June 1984 had been fully attributable to the shortfall and delays in the disbursement of external adjustment credits, including those provided by the Fund and the World Bank. He also supported Ivory Coast's request that the present arrangement be terminated on May 2, 1985 in order to correspond more closely to the period covered by the stand-by arrangement.

Ivory Coast's program was on the right track and was being implemented largely as projected, particularly with respect to the main objectives of the adjustment process, including a significant decline in the consolidated public sector deficit, further containment of the external current account deficit, and the streamlining of public enterprises, Mr. Salehkhou observed. The prospect of the successful implementation of the program had obviously improved, as all elements of the financing package had been finalized, including reschedulings by the Paris Club and by commercial banks, the release of the second tranche of the World Bank's structural adjustment loan, and the approval of the adjustment loan from the Caisse Centrale de Coopération Economique. Despite the likelihood of a decline of real GDP for the fourth consecutive year owing to further reductions in the public investment program, performance under the stand-by arrangement since its adoption in principle in May 1984 had been to a large extent satisfactory. The financial positions of the public enterprises had started to improve as a result of the rehabilitation program supported by the World Bank, and the corresponding burden on the budget was beginning to decline significantly.

Despite the important tax measures implemented within the program and the large transfers received from the Stabilization Fund, the public sector would record a relatively sizable revenue shortfall in 1984 as a result of a slowdown in economic activity and imports, Mr. Salehkhou noted. It was encouraging that the shortfall would be more than offset by savings on total expenditures and higher than expected net external resources. Nevertheless, although the original program target for the overall public deficit would be attained--reducing the deficit by the equivalent of 6 percent of GDP in 1984--it was regrettable that there would actually be a further decline in investment expenditures and a larger than expected increase in current expenditures, reflecting the recent rise in international interest rates.

The original projections for the 1984 balance of payments had been adjusted to take into account the lower level of imports induced by the slowdown in economic activity, reduced export earnings, and the increase in interest payments on external debt, Mr. Salehkhou observed. In spite of those revisions, however, the external current account deficit was still expected to record a substantial decline in 1984, moving from 13 percent of GDP in 1983 to only 7.7 percent in 1984. Moreover, the medium-term projections indicated further improvements in the second half of the decade and virtual elimination of the deficit by 1990.

The Deputy Director of the African Department, referring to the breaching of the end-June criterion on government arrears, stated that the excess of public sector arrears could be fully explained by two factors: a delay in disbursements under balance of payments loans and the lower than expected use of domestic bank credit. The staff report had referred to the delay in purchases from the Fund only to explain why drawings by the public sector under the banking system had been lower than allowed for in the program; the staff was not suggesting that the excess in public sector payments arrears was the result of that delay.

Five commercial banks were in difficulty, the Deputy Director explained; a representative from BCEAO headquarters had been assigned to supervise the operation of one bank; the national BCEAO agency was also supervising the activities of two other entirely private banks, and was presently considering their possible liquidation. There was no doubt that the BCEAO, both in Abidjan and in Dakar, was intensifying its supervisory role.

Several Executive Directors had stressed that further improvement in the current account should come largely from the parastatal sector and that perhaps one solution would be to increase the role of the private sector, the Deputy Director noted. Serious measures had already been taken to rehabilitate the sugar company, which had experienced the largest financial losses. Two consulting firms--an accounting firm and a company which specialized in oil refineries--were currently studying institutional changes for the oil refinery to determine whether the private sector could assume a greater role. At present, the refinery, which theoretically was 53 percent privately owned and 47 percent publicly owned, was reluctant to accept direction by a private company because it wanted to avoid losses; under present arrangements, private companies had a more or less guaranteed profit, because all losses were charged to the Government.

There was no doubt that the Government had taken serious measures to reduce current expenditure, both by the public enterprises and by the Central Government, the Deputy Director added. In particular, measures had been taken that would result in the reduction of scholarships, the cost of technical assistance, and the employment by the Government of expatriates from private consulting firms. Current expenditure, apart from the payment of interest charges, had practically not increased in nominal terms in the previous year. The authorities considered that the two taxes which had not been implemented--an embarkation tax and one on some kinds of equipment--were impractical; at present there were no plans for implementing them. Alternative steps might be taken to reduce expenditure or to increase the collection of other taxes. The large increase in transfers of the Stabilization Fund in 1984 was due to both higher revenues and lower expenditures. The exact accounting of the Stabilization Fund would be difficult to describe; the staff had, however, agreed on a schedule of payments and had followed very closely the transfers of the Stabilization Fund quarter by quarter.

Concerning the rationale for the use of export subsidies to maintain export competitiveness, the Deputy Director agreed with Ms. Bush that the real effective exchange rate had declined as shown in Chart 1 of the staff report; in fact, if the Chart had been extended up to the current week, the real effective exchange rate would have fallen further by about 4 percent. However, the bulk of Ivory Coast's export earnings came from primary commodities--coffee, cocoa, timber, and some petroleum products--with only modest earnings coming from manufactured or processed products, and it was in the latter area that export subsidies were being used to promote production and export. In fact, since the average protection for imports was about 25 percent, providing an export subsidy for manufactured exports did not really produce a distortion in the system; it merely brought the subsidy to the average level of protection for imports of manufactured goods.

There would be some delay in the disbursement of new money, the Deputy Director remarked. The legal documents were likely to be delivered to the Ivorian authorities only in October, which meant that the first tranche of new money would not be disbursed before the end of October.

The staff report on the second review of Ivory Coast's performance under the stand-by arrangement would be issued after the next staff mission to Ivory Coast, in November 1984, for Board consideration prior to the last scheduled purchase by Ivory Coast, which was to take place no earlier than March 15, 1985, the Deputy Director continued. The purpose of the November review--and notably of the discussions between the staff and the Ivorian authorities--would be to ensure that the program remained on track and that the transfers of the Stabilization Fund took place as scheduled. The discussions would coincide in part with the negotiation of a new stand-by program for 1985, which would be presented to the Board before the middle of March 1985, in the hope that it would be considered before the existing arrangement ended on May 2, 1985. Moreover, in future presentations of medium-term prospects, the staff could certainly show the debt service ratio by using public revenue as the denominator; that would be quite useful in the case of a country in the CFA franc area.

As to the prospects of oil production and the net share available for export, the Deputy Director of the African Department explained that the staff had assumed an increase in oil production to 2.8 million tons per year at the end of the decade. On the basis of the most recent information, that seemed to be a realistic target. A little less than one half of that production went to the consortium and somewhat more than half to the Ivory Coast. Current consumption in Ivory Coast proper accounted for about 1 million tons and exports for about half a million tons.

The staff representative from the Exchange and Trade Relations Department noted that a number of Directors had asked questions concerning the approval in principle of arrangements, and the relationship between performance criteria and the phasing of purchases from the Fund. Staff papers on both of those subjects were in preparation and were foreseen for Board consideration in the fall.

Approval in principle of Fund arrangements was a relatively recent phenomenon, which had arisen after mid-1982 when assurance was needed concerning the financing of ex ante financing gaps in programs to be supported by the Fund, the staff representative remarked. The technique of approval in principle had sought to break a deadlock between the Fund, which had wished to be assured that a program it considered supporting would be financed, and certain creditors, who wanted to be assured that Fund support for a program was indeed forthcoming. In the past, various techniques had been employed to deal with that impasse. One had been to wait until management had achieved sufficient assurance of forthcoming financing; another was approval in principle of arrangements. In general, the technique of approval in principle had been applied when there had been such uncertainty about the scale of exceptional financing, including debt relief, being forthcoming, that it might be difficult to alter the degree of adjustment foreseen in the program at the time of the mid-term review if the financing actually obtained proved to fall far short of expectations. In those cases--and Ivory Coast was one--approval in principle had been recommended to the Board, with subsequent action by Paris Club creditors and, in the present case, by commercial banks. Ivory Coast's arrangement had become effective with a relatively long delay; as a result, the performance criterion on government arrears could not be met and the synchronization of the observance of performance criteria and the phasing of purchases had fallen out of line. Based on that experience, the decision approving Zambia's recent stand-by arrangement, which had also been approved in principle, had required that the program be made effective within about three weeks. One of the recommendations in the staff paper on the approval in principle of arrangements would be to set a time limit for such approval; if satisfactory financing arrangements had not been assured by the end of, say, one month, the Board would then need to consider whether to extend the period within which the arrangement could come into effect.

Ms. Bush had asked about the use of export subsidies and had noted the need for closer cooperation with the World Bank on that matter, the staff representative from the Exchange and Trade Relations Department recalled. The difficulties that had arisen in that area over the years were explained in detail in the progress report on Bank/Fund collaboration that had been issued at the end of August (SM/84/210, 8/27/84). Differences of view had arisen not only concerning export subsidies but also, at times, concerning export retention schemes in situations where import allocation systems might be very cumbersome. The Bank had wished to be assured that certain projects it supported had sufficient foreign exchange for imports and therefore had specified that those projects be allowed to retain a certain proportion of their foreign exchange earnings. Executive Directors would be able to address those issues when they considered the paper on Bank/Fund collaboration.

Mr. Alfidja remarked first, that he agreed that consideration had to be given not only to the composition of Ivorian exports, to which the Deputy Director of the African Department had referred, but also to the direction of trade even for manufactured products. Ivory Coast was a member of the Economic Community of West African States (ECOWAS), of which Nigeria was also a member. He need hardly comment further on the impact of the closure of Nigeria's borders on the economies of small neighboring countries as well as countries like the Ivory Coast.

The recent appointment of a senior officer of the BCEAO to head one of the commercial banks that was in difficulty clearly showed the seriousness with which the authorities regarded the problem, Mr. Alfidja considered. The BCEAO representative, who had until his appointment been Director of Operations of the BCEAO, would be directly in charge of the bank in Abidjan.

His views on the impact of exchange rates on the export earnings of developing countries and the issue of access to Fund resources were well known, Mr. Alfidja noted. He was in agreement with the Chairman's remarks at the conclusion of the Board's discussion on September 5 on access limits for 1985 regarding the flexibility the Fund should exercise in dealing with countries that had undertaken adjustment measures but that still had a long way to go before the adjustment bore fruit.

He agreed with those Directors who had said that capital expenditure should not bear the brunt of further adjustment, Mr. Alfidja remarked. He could not, however, accept the idea that there was much room for maneuver as far as current expenditure was concerned. Ivory Coast, unlike most other countries, could not use the exchange rate as a tool for adjustment, and consequently had to adjust through fiscal action. That had to be carefully weighed. Unfortunately, whatever room for maneuver existed was being diminished by the rise in interest rates and the appreciation of the dollar vis-à-vis the CFA franc.

The Chairman noted that the proposed modifications would tighten up the phasing of purchases, in that the period within which the purchases would be made had been extended by three months, and the last purchase had been made subject to the observance of the performance criteria as of December 31, which had not been the case in the initial schedule of purchases. In a sense, the adjustment process had been lengthened; it had started at the inception of the program as had been initially envisaged and all the fiscal measures had been taken as planned; if the last purchase was being delayed by three months, it was to ensure that the end-December performance criteria would be met, without compressing the period of adjustment.

The Executive Board then took the following decision:

1. Ivory Coast has consulted with the Fund in accordance with paragraph 10 of the stand-by arrangement for Ivory Coast (EBS/84/81, Supplement 2, May 9, 1984) and paragraph 26 of the letter dated February 20, 1984, attached thereto.

2. The letter dated July 27, 1984 from the Minister of Economy and Finance of Ivory Coast shall be attached to the stand-by arrangement for Ivory Coast, and the letter dated February 20, 1984, shall be read as modified and supplemented by the letter of July 27, 1984.

3. Accordingly,

(a) as stated in paragraphs 18 and 19 of the letter of July 27, 1984 and the attached table, the limits that are referred to in paragraph 4(a)(i)(ii) and (iii) of the stand-by arrangement for Ivory Coast shall be read as follows: The end-September and end-December ceilings on net domestic assets (excluding coffee adjustment) shall be modified to read

CFAF 1,151 billion and CFAF 1,253 billion, respectively; the subceilings on net claims on the public sector shall be modified to read CFAF 424 billion for each of these months; the ceiling on net payments arrears shall be modified to read CFAF 179 billion and CFAF 111 billion, respectively; the ceiling on new external commitments shall be modified to read CFAF 180 billion and CFAF 200 billion, respectively; and the subceiling related to rehabilitation of public enterprises shall be eliminated.

(b) paragraphs 1 and 2(a) of the stand-by arrangement shall be amended to read:

1. For the period from the effective date of this stand-by arrangement to May 2, 1985, Ivory Coast will have the right to make purchases from the Fund in an amount equivalent to SDR 82.75 million, subject to paragraphs 2, 3, 4 and 5 below, without further review by the Fund.

2.(a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 82.75 million, provided that purchases shall not exceed the equivalent of SDR 41.38 million until December 15, 1984, and the equivalent of SDR 62.06 million until March 15, 1985.

4. The Fund decides, pursuant to paragraph 4 of the stand-by arrangement for Ivory Coast, that the first review provided for in that paragraph is completed.

Decision No. 7803-(84/141), adopted
September 12, 1984

2. ZIMBABWE - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Zimbabwe (SM/84/198, 8/15/84; and Sup. 1, 9/10/84), together with a proposed decision concluding the 1984 Article XIV consultation. They also had before them a report on recent economic developments in Zimbabwe (SM/84/208, 8/27/84).

Mr. Sangare made the following statement:

Just two years after independence, Zimbabwe's economy, affected like many others by global recession, has experienced serious economic and financial problems. Real GDP declined and inflationary pressures intensified, aggravated by the food supply situation as a result of the prolonged and severe drought which affected agricultural production. Consequently, having depleted its high stocks of maize, the country is now importing some of its food requirements. The financial situation of the Government also deteriorated as expenditure demands increased and revenue growth declined with the depressed level of economic activity. With the worsening terms of trade and depressed external demand for most of Zimbabwe's mineral and manufactured exports, the external sector also weakened despite improved production of agricultural export commodities.

Against this background, the authorities embarked upon an economic and financial stabilization program, supported by a stand-by arrangement with the Fund, which was approved by the Executive Board in March 1983 (EBM/83/52, 3/23/83). There were initial successes in implementing the program despite the continued harsh external environment and adverse weather conditions. Indeed, it was the interplay of these factors and others that made the task of economic management much more difficult. In the circumstances, the program's underlying assumptions proved untenable, and soon became inoperative. Nevertheless, the Zimbabwean authorities pressed ahead with the adjustment effort and are now working out a new program for which they intend to seek Fund assistance. Discussions to this effect are already under way with the staff.

In the meantime, the Government continues to give high priority to the objective of creating conditions conducive to sustainable economic growth. Accordingly, efforts are being directed at developing the directly productive sectors of the economy, including agriculture, mining, and manufacturing. The authorities are also giving attention to the development of infrastructure, particularly in the area of transportation, which plays a vital role in landlocked Zimbabwe. With the three-year Transitional National Development Plan 1982/83-1984/85 nearing an end, work has begun on a successor plan that will address the economy in a medium-term framework. The plan will, among other things, continue to promote a broadly based and equitable economic growth, encourage productivity in all sectors, and develop the necessary infrastructure and skills. The authorities are well aware of the delays that have hampered timely implementation of the present plan resulting from the shortfall on external receipts, and are introducing appropriate modifications to ensure smooth and timely execution of planned projects.

The outlook of agricultural production critically depends on the return of favorable weather conditions. Zimbabwe has usually maintained remunerative prices for producers and, in line with this practice, producer prices for almost all crops were raised in the 1984/85 crop season. As regards mineral production, some recovery has been projected for 1984 in view of the low level of stocks. On the other hand, manufacturing output is expected to remain low, reflecting, in part, the shortage of agricultural raw materials as a result of the low level of output following three years of drought.

The overall fiscal outturn has become worrisome in recent years as unavoidable expenditure led to program projections being exceeded. The additional expenditure, allowed for under the supplementary budget announced in February 1984, was to provide for drought relief, defense, and security, as well as financial assistance to the iron and steel company that had been particularly affected by depressed economic activity. The extra appropriation on education was in line with the schedule adopted to raise secondary school enrollment to 100 percent of primary school graduates with the objective of ultimately removing the critical shortage of skilled manpower. The Zimbabwean Government has clearly indicated that the additional expenditure announced in the supplementary budget was temporary in nature.

In presenting the 1984/85 budget to Parliament on July 26, 1984, a number of revenue-raising measures were announced to redress the fiscal position. These include a drought relief surcharge on income imposed for a 12-month period and the replacement of the sales tax on beer, tobacco, and aerated beverages with increases in their excise duties in order to improve revenue collection. In addition, duty on motor fuel was raised from Z$0.55 per liter to Z$0.625 per liter. The authorities realize that not much could be gained from these revenue raising-measures. Therefore, emphasis is being placed on further expenditure restraint. Accordingly, expansion of the civil service is being limited and public sector wage awards restricted. With this objective in mind, only those people earning less than Z$300 per month received an increase of only Z$10 per month as of July 20, 1984. The Government is also reducing transfers to parastatals through price adjustments. In this connection, a number of price measures were taken in 1982 and 1983 affecting the price of beef, fertilizer, steel, maize meal, railway tariffs, electricity, etc. Additional price increases were made effective on July 20, 1984 that raised the price of bread and cooking oil by 5 percent and maize meal by 10 percent.

The objective of monetary policy has been to restrain domestic demand while providing credit to the directly productive sectors. To this end, a number of measures were taken in 1983/84, which included raising the yield on government securities, increasing the statutory liquid asset ratio for commercial banks, and raising the statutory ratio of government and quasi-government paper that insurance companies and pension funds are required to hold. The authorities hope that, with a projected reduction in the budget deficit as proposed for the 1984/85 budget, pressure on domestic bank credit will subside.

In the external sector, an improvement in the current account balance of payments has been projected for 1984, mainly as a result of the recovery in exports. This also reflects the temporary suspension of the heavy transfers on the services account, which have averaged SDR 540 million a year since the country attained independence in 1980. As the staff report notes, these transfers were double the annual level recorded in 1979-80. This somewhat unusual phenomenon in Zimbabwe's balance of payments was inherited under the Lancaster House Constitutional Agreement of 1979 and remains a severe burden for the country. The suspension of the transfers is regarded to be temporary and was intended to provide relief to the balance of payments in light of the pressing need for urgent food imports; it would be abolished as soon as the balance of payments improved. Meanwhile, the authorities are also seeking concessionary assistance from donors abroad to finance maize imports and, if successful, this should provide part of the needed relief on the balance of payments.

The Zimbabwean authorities believe that not much could be gained in boosting exports through further and substantial exchange rate action at this time. They believe that Zimbabwe remains competitive and that the problem lies with the depressed external demand as well as other restrictive trade practices prevailing in the markets abroad. Nevertheless, they intend to keep the exchange rate under constant review and to take appropriate action whenever necessary. In the meantime, they have intensified direct promotional activities of Zimbabwe's exports abroad and reaction has been favorable thus far.

For the medium term, the balance of payments was expected to remain under pressure despite a projected 8 percent average rate of increase in exports and a reduced level of import growth. This mainly reflects the continued deficit on the services account, arising from interest payments and private transfers, among other things.

Finally, I should like to underline the fact that the Zimbabwean authorities are continuing to hold discussions with the staff with a view to concluding a new arrangement with the Fund in support of their adjustment efforts. My authorities are hopeful that the Fund will respond in a positive manner.

Mr. Clark stated that it was regrettable that after significant progress in 1983, the current stand-by arrangement had broken down, reflecting in part the difficult circumstances that Zimbabwe, like many other sub-Saharan countries, continued to face. Three years of drought had resulted in a substantial reduction in agricultural output on which about three quarters of the population depended for their livelihood, and had necessitated additional maize imports amounting to nearly one third of a million tons in 1984. Export prices of Zimbabwe's major manufactured and agricultural exports had been weak, and internally there had been continuing pressures on public expenditure following independence. All those factors had served to make the formulation of economic policies more difficult.

But given the large shortfall in revenues in 1983-84, the measures taken in the February budget to increase current expenditure and the consequent widening of the deficit were a cause of serious concern, Mr. Clark continued. As the authorities themselves recognized, a central government deficit of 12 percent of GDP--3.5 percent over the target--was far too large; given the large shortfall in both revenues and in foreign financing flows in 1983/84, gross domestic financing was estimated at 10.5 percent of GDP, which was twice the program target and represented over half of domestic savings.

On the external side, the introduction of further exchange restrictions in March was also disappointing, Mr. Clark remarked. While the authorities' concern about the deficit on the services account, which amounted to 40 percent of export earnings, was understandable, such measures not only created distortions but were also likely to damage the prospects for direct investment, notwithstanding the authorities' 1982 policy statement. As the staff had rightly noted, direct investment was an important potential source of the funds needed for financing Zimbabwe's development effort in the medium term. He therefore noted with satisfaction that the authorities regarded the exchange restrictions as temporary and he hoped that they would formulate a timetable for their removal as soon as possible.

The July budget projected a reduction in the fiscal deficit for 1984-85 to about 10.5 percent of GDP, which--although it remained too large--was at least a modest step in the right direction, Mr. Clark noted. He also understood that the authorities had announced a preplanting price for maize in line with the staff's recommendation of Z$180 per ton. Nevertheless, the substantial financing gap which the staff had projected for 1985 and beyond underlined the extent of the imbalances in the Zimbabwean economy and the pressures which would continue to be felt. He hoped that the authorities and the staff would be able to reach agreement on ways to tackle those imbalances in the context of a new Fund program, which would be important not only in facilitating adjustment, but also in encouraging renewed capital inflows.

The deterioration of private savings by 5.5 percent of GDP between 1982/83 and 1983/84, especially in light of the need for investment in both the public and private sectors to renovate Zimbabwe's capital stock, was worrying and underlined the necessity of restraining current expenditure, Mr. Clark added. The authorities were to be commended, therefore, for the restrictive wage policy they had followed in the past two years together with the strict limits on new hiring for the civil service; he welcomed the decision to continue those policies in 1984/85. It was clear, however, that considerable scope remained for improving the financial situation of the parastatals. Transfers to the parastatals accounted for nearly one third of the central government deficit, and the operating losses of those institutions, at 1.5 percent of GDP, exceeded the amount of those transfers, the balance being largely financed through the Reserve Bank. He hoped that the authorities would be able to act quickly to improve the situation, and in particular, to implement the necessary price increases in the agricultural, airlines, and railway industries. Moreover, interest rates seemed to be negative in real terms on a number of savings instruments; he therefore encouraged the authorities to move to positive real rates as soon as possible.

The staff's projections indicated that the balance of payments situation remained extremely difficult, Mr. Clark observed. In particular, the debt service ratio--allowing for new borrowing--was projected to rise to over 30 percent in 1987, and would be several percentage points higher if account were taken of the high level of short-term debt. He therefore urged the authorities to encourage exports and to avoid recourse to nonconcessional borrowing. An appropriate exchange rate policy was an important element in maintaining export competitiveness, and in that context he noted with some concern the nearly 5 percent real appreciation of the Zimbabwe dollar since the beginning of 1983.

He agreed with the staff that both foreign and domestic capital would be required to finance a sound medium-term development plan, Mr. Clark remarked. Efforts had to be made not only to attract private direct investment but also to improve public savings, increase private savings, and reverse the declining trend in corporate profitability. He therefore supported the staff's recommendation that such a development plan be formulated in conjunction with the World Bank.

Mr. Qureshi stated that in recent years, economic policymaking in Zimbabwe had had to contend with difficult circumstances that had been exacerbated by adverse exogenous developments, such as the severe drought that had affected crops in three successive years, the impact of the worldwide recession, and the continuing effects of the situation inherited by the present Government. The authorities were to be commended for having initiated several necessary steps toward adjustment, including exchange rate adjustments, increases in producer and consumer prices, improved monetary management, restraining public expenditure growth, strengthening the financial position of public bodies, holding down wage and salary adjustments, and restraining import growth. Because of adverse exogenous developments, however, improvement in the economy's growth and financial performance had fallen short of expectations. The continuing financial and structural difficulties facing the economy only served to emphasize further the need for sustaining--and where necessary strengthening--the adjustment effort.

Considerable further fiscal adjustment was needed, Mr. Qureshi continued. The larger than anticipated budget deficit in 1983/84 had resulted partly on account of unavoidable increases in expenditures necessitated by security requirements and drought conditions. For the coming financial year, however, the recently announced budget projected a decline in the deficit and reductions in several categories of current expenditure. In view of the already high tax rates, any further increases in revenue would result largely from improvements in collection and the recovery of economic activity. Consequently, the reduction of the fiscal deficit would largely be accomplished through expenditure restraint and improvements in the financial position of the parastatals.

Current expenditures had been particularly large, Mr. Qureshi observed. However, a significant proportion of the increase in recent years had resulted from the inclusion of increases in expenditure on education and other activities of a developmental character in the category of current expenditures. He would appreciate staff comment on the relative role of such types of expenditure in explaining the growth of aggregate current expenditure in recent years and whether the composition of current expenditure had been improved as a result.

With respect to monetary policy, Mr. Qureshi noted that the authorities should continue to restrain demand and to limit the expansionary effect of the budget deficit; at the same time, they should continue to permit the provision of adequate credit to productive sectors, especially the drought-stricken agricultural sector.

In the external sector, the trade balance had moved from deficit to surplus in 1983, Mr. Qureshi remarked. The expected growth of exports in the period ahead should contribute to strengthening the trade balance and to a further reduction of the current account deficit, as shown in the medium-term balance of payments projections. The overall payments imbalance and financing requirements, however, were expected to remain large. As Mr. Sangare had noted, owing to the constitutional history of the country, heavy transfers on the service account would persist in the future. The authorities should continue to make efforts to boost exports, including the continuation of their flexible exchange rate policy. Their efforts to strengthen the payments position would be helped by an improvement in the outlook for capital inflows, which had tended to fall far short of expectations. An early conclusion of the current negotiations for a new arrangement with the Fund would be particularly useful.

Wide-ranging adjustments in wages and prices were continuing, Mr. Qureshi observed. Policies during the past year had continued to emphasize the maintenance of stringent wage restraint, the provision of greater incentives to farmers through increased procurement prices, and the reduction of the losses of agricultural marketing boards through increased consumer prices. The staff had usefully drawn the authorities' attention to areas where further price flexibility and adjustment might be needed. The authorities had also been pursuing a fairly stringent policy of wage restraint in the public sector, and that policy had had the unintended effect of moving some skilled manpower out of the government sector and contributing to emigration. That pointed to an interesting dilemma for the authorities: while wage restraint was required for demand management and to improve the fiscal position, it was also important that the efficiency of the public sector--which played a key role in Zimbabwe's economy--not be undermined. He invited staff comment on the scale of the drift of skilled manpower away from the public sector, and how that was related to the changing structure of rewards in the system.

Since many of Zimbabwe's problems were of a structural nature, he was encouraged to note the increasing involvement of the World Bank in the country, Mr. Qureshi concluded. The Bank could play a useful role in the preparation of a medium-term investment plan and in helping to arrange adequate financing for it.

Ms. Lundsager noted that during the Board's discussion of the review of Zimbabwe's stand-by arrangement in January 1984, Executive Directors had welcomed the progress of adjustment in Zimbabwe and had been optimistic about continued success, so long as the authorities remained committed to the program's policy path. It was unfortunate that only one month following that review, the authorities had announced measures--a supplementary budget plan that exceeded the program's target and exchange restrictions--that had rendered the program's objectives unobtainable. While drought had contributed to Zimbabwe's difficulties, financial imbalances in the Zimbabwean economy had become more severe, and the need to take further adjustment measures to bring about a sustainable balance of payments position and reasonable economic growth had become even more pressing.

Zimbabwe's serious financial situation called for a careful balance between policies aimed at both demand restraint and supply incentives, Ms. Lundsager remarked. Although the Government's development plan showed awareness of the need to provide a base for future growth, the authorities should finance those expenditures through the existing resource base. Hence, the budgetary expenditures had to be reduced to a level that could be financed on a sustainable basis. Continued wage restraint and appropriate increases in producer and consumer prices were essential; the July price increases indicated that the authorities were aware of the importance of price signals. In addition to reducing current expenditures to leave room for investment, the tax system should be reviewed and revised as necessary to prevent high tax rates from being a disincentive to domestic savings and investment. Further, the authorities should follow through on their commitment to increase the efficiency of the parastatals whose deficits were draining government resources.

In order to promote growth over the medium term, Zimbabwe needed to increase its investment efforts, Ms. Lundsager considered. She agreed with the staff that a better formulated medium-term investment strategy could be used to increase donor support for development projects. Moreover, reductions in the Government's current expenditures could make more credit available for private sector investment needs; a concentration of investment in manufacturing, a sector not affected by severe weather conditions, could also promote increased productivity; and a lifting of the exchange restrictions imposed in March would help to provide a climate more attractive to foreign investors.

Even with moderate growth in exports and imports and some increase in net capital inflows, there might be a total balance of payments financing gap as high as SDR 150 million in 1985 and 1986, Ms. Lundsager remarked. In addition, the debt service ratio, at nearly 24 percent in 1984, and with further increases expected, remained high. In view of those large imbalances, the authorities should further increase the flexibility of their exchange rate management to restore competitiveness and to encourage a shift of resources to the export sector.

Finally, any new Fund program negotiated with Zimbabwe should include greater expenditure reductions than those provided for in the proposed 1984/85 budget presented in SM/84/198, Supplement 1, Ms. Lundsager considered. Additional measures should be formulated and complemented as soon as possible if the authorities were to move forward toward a successful program. She supported the proposed decision.

Mr. Salehkhou expressed his surprise at the timing of the 1984 Article IV consultation with Zimbabwe. The 1983 consultation had been concluded on January 9, 1984, with the expectation that the next one would be held on the standard 12-month cycle, or about four months hence. Furthermore, the staff report for the 1984 consultation had been prepared while the authorities were in the process of assessing the basic elements of their policies and adopting the Government's budget for 1984/85. Thus, there had clearly been a case for delaying by a month or two the present discussion until the authorities could be more specific about the details of their policies. He invited staff comment on that matter.

The performance of the Zimbabwean economy in the past two years had been to a large extent unsatisfactory, Mr. Salehkhou continued. That was all the more disappointing as the authorities had been implementing a number of far-reaching adjustment policies during that period, particularly in cooperation and with the support of the Fund and the World Bank. Despite the favorable impact of such policies in correcting some of the economy's distortions, including the significant improvement in the competitiveness of Zimbabwe's export products, the adjustment effort had been upset by a number of adverse factors. Thus, it had not been possible to prevent a substantial deterioration of domestic and external imbalances and negative or very low rates of real economic growth.

Prominent among those adverse factors was the prolonged drought, which had deeply affected the agricultural sector and had created a heavy burden on the balance of payments, as it had made it necessary for the authorities to offset some of the shortfall in agricultural production with costly food imports, Mr. Salehkhou remarked. The staff report also emphasized the impact of scarce foreign exchange and the lower level of capital inflows on imports and growth. However, insufficient emphasis had been given to a number of constraints that had been inherited from

Zimbabwe's colonial era, particularly the large currency outflow on account of income and private transfers which were in the words of the staff, "a large burden on a developing economy." The Zimbabwean authorities had also inherited from the colonial era enormous obligations with respect to a large majority of the population whose needs had not been properly addressed before independence and whose expectations in terms of economic equality and access to social services were of crucial importance to policymakers.

Those factors and constraints had clearly provided the basis for the measures implemented in early 1984, which had made it difficult for the authorities and the staff to conclude the second review of the stand-by arrangement, Mr. Salehkhou added. Last February's supplementary budget, its excessive reliance on domestic bank financing, and the introduction of various restrictions on current payments had hardly been consistent with the program's overall objectives; those measures, however, had apparently been instrumental in cushioning the impact of adverse developments and harsh adjustment policies on the low-income segment of the population. They had also been aimed at securing essential imports made necessary by the prolonged drought.

With regard to economic and financial policies for 1984/85, Mr. Salehkhou noted that although many of the new restrictions had been maintained, the authorities had reaffirmed that they were temporary and that they would be removed as soon as the balance of payments position permitted. He further noted that important elements of the program adopted in the past year and supported by the Fund were part of the authorities' efforts to contain the deterioration of domestic and external imbalances. Those elements included, in particular, a flexible exchange rate policy, the promotion of exports, and restrictive fiscal and monetary policies. Also some improvement was projected in both the public sector and external current account deficits.

The level of domestic and external imbalances, however, would remain unsustainably high, Mr. Salehkhou observed, while the pressures induced by service payments on government and government-guaranteed external debt would become much heavier throughout the decade. Thus, cooperation with the Fund and the World Bank in the medium term would be crucial in addressing present difficulties. It was notable that although the authorities had major differences with the staff about the feasibility or appropriateness of some policy initiatives, they had expressed their willingness to enter into a new stand-by arrangement with the Fund. While the adoption of a new program would necessarily result in an acceleration and strengthening of the authorities' efforts, its success would, to a large extent, depend on the flexibility of the Fund's recommendations and their consistency with Zimbabwe's particular circumstances. He supported the proposed decision.

Mr. Hammann said that he was in full agreement with the staff appraisal and supported the proposed decisions, especially the recommendation not to approve the exchange rate restrictions introduced in March 1984.

Unfortunately, Zimbabwe had not used the opportunity to reduce its sizable internal and external imbalances by adhering to its stand-by arrangement with the Fund, Mr. Hammann remarked. An increase in expenditures and the introduction of further exchange restrictions had made the program objectives unattainable. That was regrettable since the necessary global and structural adjustments would be delayed and capital inflows would be discouraged. The best advice that could be given in the present situation was probably to return to the policies described in the program of last year; without a comprehensive approach characterized by an appropriate management of global demand, appropriate pricing and wage policies, and a flexible exchange rate policy, internal and external imbalances were unlikely to be addressed successfully.

A renewed and determined effort to contain expenditures, to strengthen revenues, and to improve the performance of the parastatal sector, was essential if the overall public sector budget deficit was to be brought within acceptable dimensions, Mr. Hammann considered. Fiscal policy should play a prominent role in checking domestic demand and mobilizing domestic savings. It was therefore regrettable that the new budget for 1984/85 provided only for a limited improvement in the overall fiscal situation. Revenues would increase only slightly faster than expenditures; thus, the deficit in relation to GDP would remain above 10 percent. To finance the budget the authorities were planning to take larger recourse to foreign sources and to ease the pressure on domestic sources; it was difficult to imagine how they could do so in view of the already high external indebtedness and the intensification of restrictions, which did not inspire confidence.

Among other items, the new budget allowed for an increase in subsidies by more than 22 percent, whereas expenditures in the education sector were to be reduced again, Mr. Hammann observed. Did that represent an explicit policy change, since education-related expenditures had been accorded a high priority in the supplementary budget in early 1984?

In concluding, Mr. Hammann expressed the hope that Zimbabwe would again seek the advice and cooperation of the Fund in order to tackle its serious internal and external imbalances.

Mr. Joyce noted that drawings under the existing stand-by arrangement had been suspended because of Zimbabwe's failure to meet the program targets earlier in the year. Meanwhile, discussions had been proceeding on the possibility of a new 18-month stand-by arrangement to replace the present one that expired in September. He appreciated the difficulties that Zimbabwe was facing because of both the international economic situation and the severe drought conditions in 1983 with its impact on agricultural production and, consequently, upon the food processing industry; in those circumstances, the original program might well have been seriously at risk when it entered into effect in 1984. Even if that had been so, the authorities had delivered the coup de grâce in introducing a supplementary budget in February which had substantially increased government expenditures, with consequential implications for government borrowing and the level of domestic bank financing. It was only in the July budget that new revenue-raising measures had been introduced.

As Mr. Sangare had stated, the authorities had realized that the measures proposed were unlikely to go far toward restoring balance, Mr. Joyce continued. Reductions in expenditure must be made, and the authorities must move further and more quickly in setting prices at appropriate levels. Those two steps would provide better incentives for increased production and would help reduce the calls on the Treasury. He was concerned, however, that what had been done on the price and revenue side was too little and too late. It was not particularly reassuring to note that the expenditure increases which had resulted in the program projections being exceeded were, as characterized by Mr. Sangare, unavoidable. He hoped that progress was being made in the discussions with the Fund in identifying means to reduce the fiscal deficit to an acceptable level and to reduce or eliminate the restrictions on foreign payments and transfers which had been intensified in recent months as the balance of payments deteriorated. In the circumstances, he agreed that it would be inappropriate to approve the exchange restrictions introduced in March 1984; he did, however, commend the authorities for their decision to restrain expansion in the public service and to restrict public service wage awards.

He had great sympathy for the economic and political situation in which Zimbabwe found itself, Mr. Joyce added. Building a new nation was never easy, but if the Fund was to help and if the assistance provided by the Fund was to be effective, Zimbabwe had no alternative but to decide on its expenditure priorities and stay within the bounds of what was financeable. Any other policy stance could only compound the country's difficulties, and in turn either reduce national competitiveness or force major compensating changes in the rate of exchange.

While on reflection the Zimbabwean authorities might have regarded the criteria under the present program as too restrictive, there appeared to be no difference of view between the authorities and the Fund on the need to improve Zimbabwe's economic performance to bring it back onto a more sustainable track. It was unlikely, however, that the requirements under any new arrangement would be less demanding than those that had been judged necessary in the past; indeed, to make up lost ground, a more intensive fiscal effort might be needed together with much greater price flexibility.

He agreed with the staff that it was important for Zimbabwe to maintain its financial credibility so as to attract increasing flows of private capital funds and concessional aid. It was therefore important for the authorities to propose, in cooperation with the World Bank, a medium-term investment plan. He hoped that the current negotiations with Zimbabwe on a stand-by arrangement could be brought to an early conclusion and that with renewed determination on the part of the authorities, a new program could be worked out that would provide a sustainable basis for Zimbabwe's medium-term development.

Mr. Polak stated that Fund-supported programs had been implemented in Zimbabwe, off and on, since the beginning of 1983, but the staff paper confirmed that internal and external imbalances in the past year had increased instead of decreasing, in spite of obvious concern on the part of the Zimbabwean authorities to keep the adjustment process going. A new, prolonged discussion had not yet led to agreement on a new program for 1984/85. The authorities apparently had felt unable, partly because of the drought and security-related reasons, to implement the necessary budgetary measures. But the Fund, on its side, could not engage in a program that lacked the potential to contribute substantially to a medium-term solution of Zimbabwe's external imbalances. While he understood the painful choices that had to be made and the difficulties involved in forging a consensus in favor of an economic adjustment program, he considered the alternative grave: a slide into a prolonged impasse. He hoped that that impasse would be avoided.

As for the thrust of a new program, he broadly shared the staff appraisal, Mr. Polak continued. It was clear that a return to normal weather conditions could contribute to a considerable improvement in the economic situation, but the restoration of external balance seemed out of the question without further policy adjustments. Among policies, fiscal policy was the key. Current government expenditures had increased extremely rapidly since 1981/82; while full implementation of the 1984/85 budget would entail a commendable reduction in that category (by 5 percent of GDP), the overall deficit reduction (by 1.5 percent of GDP) nevertheless did not seem sufficient.

The staff report and the appraisal were quite vague on the question of the exchange rate, Mr. Polak observed. In previous Board discussions on Zimbabwe, he had raised the question whether the level of the exchange rate was not too high to be compatible with the desired return to a sustainable balance of payments position. Nonetheless, the staff papers had failed to address that question, stating only that the exchange rate had appreciated by about 5 percent in real effective terms since early 1983. A far more thorough analysis seemed to be required. He recalled the remarks by the staff representative in January (EBM/84/3, 1/9/84) "that the problems in Zimbabwe lay not in producing the goods but in finding the markets and buyers for them." If it was true that the required supply capacity existed, correct price settings seemed of crucial importance.

In that context, Mr. Polak added, one could cite the adoption of new exchange restrictions as evidence of overvaluation. He appreciated that, on the one hand, the realization that further Fund purchases could not be made and, on the other hand, the necessity for emergency cereal imports had played an important role in the decision by the authorities to adopt those restrictions. However, it seemed clear that with the present policy stance, the phasing out of those restrictions could not be expected, and yet the prospect of that happening would be a requirement for a new program.

In concluding, Mr. Polak stated that he approved the decision.

The staff representative from the African Department, referring to the timing of the 1984 Article IV consultation, remarked that the 1983 Article IV consultation discussions and the first review of the 18-month stand-by arrangement had taken place in Zimbabwe in May 1983 and had been prolonged by discussions on policy measures for 1983/84. The mission had found government credit for June 1983 to be somewhat in excess of the target and that it would therefore be necessary to present a request for a waiver to the Board. In addition, there had been further discussions regarding wages, prices, and other policy instruments. Consequently, the staff report for the 1983 Article IV consultation had not come to the Board until January 1984.

The staff had decided against a delay for two reasons, the staff representative commented. First, many Executive Directors had been concerned about the measures taken in February/March--the adoption of a supplementary budget and the introduction of exchange restrictions--and had asked the staff to present its report as soon as possible in order to inform the Board about the circumstances that had led to deviations from the stand-by program, especially as those developments had arisen immediately after the conclusion of the 1983 consultation in January. The staff therefore considered it desirable to provide Executive Directors, as soon as possible, with a background paper describing the present situation and the prospects for discussions with the Zimbabwean authorities.

Second, there were some advantages from a statistical point of view to holding the consultations as scheduled, the staff representative added. The final figures for the past fiscal year had been currently available; normally figures on production and the balance of payments tended to be available on an annual basis. Had the consultation been delayed for six months, the staff would have had to include 1984 figures, for which there would have been only partial estimates.

As to the impact of wage restraint on the exodus of skilled manpower from the public sector, the staff representative noted that wages in the public sector tended to be lower than wages in the private sector. According to available figures derived from tax information, there were about 10,000 people in Zimbabwe earning more than Z$18,000 per year; of that number, only 500 were in the public sector. Better salaries and remuneration in the private sector were one explanation for the drift. Government employment, however, had not been declining, and it was still higher than considered desirable; according to available figures, government employees numbered 51,000 (excluding the armed services) in 1982, 77,000 in 1983, and 80,000 in 1984. The increase in hiring had slowed, and it was the intention of the Government to continue to reduce the rate of increase.

As to whether the decrease in education expenditures in the 1984/85 budget represented an explicit change in government policy, the staff representative noted that the staff would be requesting clarification of the new budget estimates during its discussions with the authorities at the Annual Meetings in the coming week. However, in May the authorities had told the staff mission that whereas it had been their intention to increase the enrollment in secondary schools from 70 percent to 100 percent of primary school graduates, actual enrollment was closer to 90 percent; it was therefore possible that the lower figure had been used in the estimates for 1984/85. The authorities had also indicated that they would increase fees in a more concerted effort to limit the demand for education. The staff had not yet seen any announcement along those lines, but one might be forthcoming before the beginning of the next school year in January 1985. It was notable that from 1979/80 to 1983/84 education expenditures quadrupled, while current expenditures increased 2.5 times; despite the proposed reduction, education represented the largest share of total current expenditure.

In view of domestic and external imbalances, the exchange rate should continue to be used flexibly, the staff representative from the African Department noted. However, the staff considered that the recent appreciation had not been a move in the right direction and that during the period of the new stand-by arrangement the exchange rate should be adjusted. That would be one of the subjects for discussion at the staff's next meeting with the Zimbabwean authorities.

The staff representative from the Exchange and Trade Relations Department, commenting on the timing of the 1984 Article IV consultations, stated that the staff had felt it appropriate to hold its consultation discussions in May for yet another reason: May was the time when important decisions were made with regard to the budget for the next July/June fiscal year. Also, since the authorities had expressed an interest in discussions concerning a new arrangement, it had seemed reasonable to conduct those discussions in line with the fiscal year.

Mr. Sangare noted the Board's concern about the widening of the budget deficit and its impact on other aspects of Zimbabwe's financial situation, particularly the exchange rate. Concern about the expansionary budgetary outlook was quite understandable given the size of the deficit, which exceeded the program target. He agreed with Mr. Salehkhou that the root cause of the problem lay in the historical past. In Zimbabwe, independence had increased expectations that had their roots in disparities between different social groups; a substantial part of the expansion in government expenditures had been to meet those expectations. For example, the "extra appropriations" on education, which he had mentioned in his opening statement, had been intended to remove the disparity in the standard of education that existed between skilled and unskilled manpower groups prior to independence. However, the Zimbabwean authorities recognized the large size of the deficit, and they were continuing to seek ways of reducing it. That would form part of their agenda during the Annual Meetings.

Concerning the parastatals, Mr. Sangare noted that while progress had been made in reducing transfers to some of the state corporations, such as the electricity corporation which was now financially self-sufficient, some of the corporations remained problematic. The iron and steel company, for example, had been adversely affected by the lack of external demand. What was important in dealing with the parastatals was to devise a policy which would improve the corporations' financial positions, in order to make them self-supporting.

The authorities intended to continue their flexible exchange rate policy, Mr. Sangare remarked. They did not, however, see the merit of drastic exchange rate action while they still maintained a competitive edge. In the meantime, and in line with the system of smooth and gradual exchange rate movements, they had undertaken a campaign to promote Zimbabwean products through fairs and exhibits, which appeared to have been effective.

The authorities had been steadfast in their wage policy, Mr. Sangare observed, as they had kept a freeze on wages for the second year. That demonstrated their determination to achieve the objectives of the program, particularly as several prices had been allowed to increase over the medium term. The authorities were, however, concerned about the implications of wage constraints for the public sector. They would therefore continue to view their wage policy very carefully in order to maintain a balance between the need to restrain wages and the need to maintain the level of skilled manpower in the public sector.

The Chairman, emphasizing a point to which a number of Directors had alluded during their discussion, commented that the explosion of the government budget shown in Table 1 on page 3 of the report was indeed striking. Current expenditure had risen 10 percentage points in three years--from 32 percent of GDP in 1980/81 to 42 percent of GDP in 1983/84. The fact that revenues had also risen by 10 percentage points--from 26 to 36 percent--was also noteworthy. There appeared to be some relationship between the explosive growth of the public sector and the shrinkage of domestic investment and profitability during that period: in three years, the Government had taken an enormous amount of resources out of the economy; in the same period gross domestic investment had declined from 28 percent of GDP to about 22 percent of GDP. Notwithstanding the freeze in wages, which had led to a loss of skilled labor, the expansion in the public sector accounted for about 50 percent of GDP. The crowding out of private sector investment and its implications for medium-term growth prospects were of very great concern. The real problem was the size of Government; the answer was not more taxes but rather the curtailment of current expenditures and further restraint in the hiring of public sector personnel.

The Chairman made the following summing up:

> Executive Directors were in broad agreement with the general assessment and views expressed in the staff appraisal. They noted the difficult internal and external circumstances that the authorities have had to deal with during the last two years, particularly the impact of the prolonged drought, which sharply reduced food production, agricultural exports, and supplies of raw materials.

Directors commended the difficult measures introduced by the authorities since the beginning of the stand-by arrangement in early 1983. These included substantial increases in utility tariffs and prices of basic commodities, stringent wage restraint in the public and private sectors, and new fiscal revenue measures. They regretted, however, that the momentum of adjustment was not maintained in 1984 and that important policy slippages had occurred, in particular through the adoption of a supplementary budget and additional exchange restrictions. Stronger measures of demand restraint as well as supply incentives needed to be urgently implemented. In this context, they emphasized the need for fiscal discipline by restricting the growth of public expenditure, especially recurrent expenditure. Expenditure had grown faster than government revenue and the economy, and currently represented nearly 50 percent of GDP. Moreover, the overall public sector deficit had risen to the equivalent of 12 percent of GDP in fiscal 1983/84, which Directors regarded as excessive. They added that fiscal discipline would facilitate the conduct of an appropriately tight monetary policy without crowding out the productive enterprises sector. It was also stressed that a restrictive wage policy should be continued and that the reliance of public corporations and agencies on large government loans and subsidies should be curtailed sharply through timely pricing decisions. Concerning the 1984/85 budget, Directors welcomed the authorities' efforts to restrain the growth of recurrent expenditure but stressed that these efforts needed to be reinforced with additional measures. Restraint in hiring of public sector personnel, further sizable cuts in current budget expenditures, and significant improvements in the operations accounts of public sector enterprises were emphasized by Directors in that context. A review of the tax system was also called for.

Directors also noted the difficult medium-term outlook for the economy, with low savings and investment ratios, as well as a rising debt service ratio. Directors emphasized the need for redirecting resources to the productive sectors, especially in the export sector. Directors observed that the public sector was absorbing resources at a rate that was restraining the expansion of the productive sectors.

Regarding the need for increased investments, Directors said that, given resource limitations in the public sector, measures to promote private investment should be pursued, including greater freedom of companies to manage their enterprises efficiently, as well as the liberalization and the formulation of a timetable for the removal of exchange restrictions on the repatriation of foreign investor profits and dividends. In view of the large projected financing gaps in 1984 and 1985, Directors urged the authorities to undertake the necessary adjustment to reduce these gaps to financeable levels and to prepare a realistic medium-term investment program with the assistance of the World Bank, in support of which they should redouble their efforts in securing appropriate external assistance. Given the high and rising debt service ratio, Directors urged great caution with regard to external borrowing.

Directors urged the authorities to continue with their export promotion efforts and added that a flexible exchange rate policy would be essential for maintaining the competitiveness of Zimbabwe's exports. They noted the appreciation of the exchange rate, which they thought did not go in the right direction. They also stressed that greater flexibility was needed in the present exchange control regime.

Finally, Directors hoped that Zimbabwe would adopt a comprehensive policy program which could attract Fund financial support.

It was agreed that the next Article IV consultation with Zimbabwe should be held on the standard 12-month cycle.

The Executive Board then took the following decision:

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

2. The restrictions on the making of payments and transfers for current international transactions are maintained by Zimbabwe in accordance with Article XIV except that the exchange restrictions arising from the temporary suspension in March 1984 of remittances of certain incomes (as described in SM/84/208) are subject to approval under Article VIII, Section 2(a). The Fund encourages the authorities to take measures that will permit the elimination of these restrictions as soon as possible.

Decision No. 7804-(84/141), adopted
September 12, 1984

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/140 (9/10/84) and EBM/84/141 (9/12/84).

3. THE GAMBIA - 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 Gambia to not later than October 31, 1984. (EBD/84/240, 9/7/84).

Decision No. 7805-(84/141), adopted
September 11, 1984

4. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 84/51 are approved. (EBD/84/235, 9/4/84)

Adopted September 10, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, and by an Advisor to Executive Director as set forth in EBAP/84/192 (9/10/84) is approved.

APPROVED: July 3, 1985

LEO VAN HOUTVEN
Secretary