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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/169

3:00 p.m., November 26, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	J. K. Orleans-Lindsay, Temporary
C. H. Dallara	M. Lundsager, Temporary
	H. G. Schneider
	X. Blandin
	C. Flamant, Temporary
M. Finaish	M. B. Chatah, Temporary
	N. Haque, Temporary
	T. Yamashita
G. Grosche	B. Goos
J. E. Ismael	
R. K. Joyce	L. Leonard
	G. D. Hodgson, Temporary
	C. Robalino
	A. S. Jayawardena
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	E. M. Taha, Temporary
	E. M. Ainley, Temporary
	G. Ortiz
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	A. Lindå
N. Wicks	T. A. Clark
	J. Bulloch, Temporary
	D. J. Robinson, Temporary
S. Zecchini	N. Coumbis
	Wang E.

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

Also Present

African Department: A. D. Ouattara, Director; E. A. Calamitsis, C. Enweze, J. E. Greene, C. J. Hoban, S. M. Nsouli, R. L. Sharer, A. Tahari, A. C. Woodward. Exchange and Trade Relations Department: E. H. Brau, T. Hatayama, S. Kanesa-Thasan, M. G. Kuhn, N. E. Weerasinghe. Fiscal Affairs Department: S. Richupan, A. Tazi. IMF Institute: I. B. Gado, E. G. Mwela, M. M. Yagne, Participants. Legal Department: W. E. Holder, Ph. Lachman, J. M. Ogoola. Research Department: N. M. Kaibni. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Berthet, Q. M. Hafiz. Western Hemisphere Department: S. T. Beza, Associate Director. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: H. A. Arias, S. M. Hassan, M. Z. M. Qureshi, A. Steinberg, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: J. R. N. Almeida, I. Angeloni, W.-R. Bengs, M. Camara, G. Ercel, J. M. Jones, A. K. Juusela, H. Kobayashi, R. Msadek, A. Mustafa, E. Olsen, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, A. J. Tregilgas, A. H. van Ee, B. D. White.

1. ARGENTINA - REPORT BY MANAGING DIRECTOR

The Chairman said that on November 25-26, 1984 he had discussed developments in Argentina with bankers in New York City. In particular, he had described Argentina's adjustment program and had indicated possible ways of financing it.

The Executive Directors noted the Chairman's remarks.

2. ZAMBIA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the review under the stand-by arrangement for Zambia (EBS/84/229, 11/9/84; and Sup. 1, 11/23/84).

The staff representative from the African Department said that all the performance criteria for end-September 1984 had been observed except those relating to arrears, for which a waiver had been proposed. The authorities had recently given the staff a further indication that they were continuing the policy of steadily depreciating the kwacha. In addition, following the decontrol of prices on November 2, 1984, the prices of bread and wheat flour had risen by 70-90 percent. Finally, copper prices had firmed slightly; the average price of $0.61 per pound assumed in EBS/84/229 was likely to be exceeded by a small margin. Hence, the volume of shipments estimated in the program--530 thousand metric tons--still seemed realistic.

Mr. Abdallah made the following statement:

> The Zambian authorities continue to endeavor in their adjustment effort to reduce the domestic and external imbalances in their economy, despite unfavorable external developments. They have implemented most of the measures envisaged under the 1984 stand-by arrangement, thereby confirming their strong commitment to the objectives of the program. A flexible exchange rate policy has been in place, and several revenue-generating and expenditure-saving measures were adopted. Producer prices were increased to stimulate production, and interest rates were adjusted upward to improve credit allocation and to help mobilize domestic savings. Prices of several commodities were decontrolled, and several actions were taken to strengthen the financial performance of the parastatals. The authorities also took a number of steps toward consolidating and rescheduling external debt and reducing arrears.
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> Notwithstanding the wide array of appropriate domestic policies now being implemented, recent performance has again emphasized the vulnerability of the Zambian economy to exogenous influences and, in particular, to the continuing depressed price

of copper in the world market which has led to a more than 70 percent decline in the purchasing power of Zambia's exports over the last decade. The resulting severe foreign exchange shortage, aggravated by reduced net capital inflows, has militated against the authorities' effort to adjust the economy. With continued lack of essential imported inputs, performance of the productive sector deteriorated, and real GDP showed no growth in 1984. Nonavailability of foreign exchange has also made it impossible for Zambia to meet the program's September performance criterion on reduction of external commercial arrears through cash payments, and as a result a request is being made for the requirement to be waived and the December arrears target to be modified.

In the external sector, the authorities are committed to a policy of promoting export diversification and import substitution through a flexible exchange rate policy. The kwacha has been depreciated by more than 100 percent since January 1983, and in an effort to promote nontraditional exports, the authorities have introduced foreign exchange retention schemes. Despite all this, the balance of payments difficulties have intensified. A further decline in copper prices meant lower export proceeds, which, coupled with higher than projected debt service payments reflecting increased interest payments, aggravated an already difficult foreign exchange shortage. These developments in the external sector adversely affected the productive capacity of the economy and the financial position of the Government through further compression of imports, including basic inputs. Having recognized the gravity of the situation, the authorities are determined to continue the stabilization program and to keep in close consultation with the Fund. The authorities also recognize the need to improve the existing arrangements for foreign exchange allocation.

In an effort to alleviate the external debt position, a rescheduling agreement was reached with the Paris Club, and discussions for similar arrangements with commercial and other creditors are under way. In compliance with the terms of the Paris Club, last August the authorities established an external foreign account into which monthly deposits are to be made. They are also determined to prevent any further increase in commercial payments arrears. However, in view of the difficult external position facing Zambia and its dependence on developments in the world copper market, success of the appropriate domestic policies being pursued by the authorities will crucially depend on the support of the international community to relieve the severe resource constraint in the economy and in particular the acute shortage of foreign exchange through a substantial inflow of concessional assistance and adequate debt relief over the medium term.

On the fiscal front, the authorities implemented a number of measures to contain expenditure and generate more revenue and were successful in meeting the program ceiling on bank credit to government. The policy of expenditure restraint was maintained, including cautious employment and wage policies. Despite the adverse impact of the sluggish economic activity on public revenues, tax receipts in 1984 are expected to be higher than projected, reflecting improved tax collection and implementation of new import tax measures. However, due to the larger than envisaged budgetary impact of the exchange rate depreciation, the overall budget deficit in 1984 is expected to reach 5.2 percent of GDP, slightly higher than the program target of 4.5 percent, but substantially lower than the 6.9 percent in 1983. The authorities intend to maintain the program target through mobilizing additional external resources and domestic nonbank borrowing. Further improvement in tax collection and new revenue-generating measures will be considered in the context of the 1985 program. The technical assistance from the Fund should help to improve the monitoring and control of expenditure.

So far as monetary policy is concerned, developments have been consistent with the program target. The ceilings on government bank financing and credit to the mining company were observed, and the net increase in domestic assets of the banking system and growth of money supply remained within the program limits. However, the seasonal increase in demand for credit by the agricultural sector and the parastatals may create considerable pressure on banks to expand credit. The flexible exchange rate and price liberalization policies, coupled with the recent increase in interest rates adopted by the authorities, are expected to curb excessive demand for credit and improve its allocation. The authorities intend to reinforce the restrained monetary policy in line with the program objectives. The Central Bank is working in close cooperation with the commercial banks to ensure that the credit limits under the program are observed.

The Zambian authorities are committed to the policy of diversification and structural adjustment of the economy. To this end, they have adopted a policy of price liberalization and a flexible approach to adjusting producer prices. Apart from the substantial increase in prices of a number of key commodities early this year, the authorities have implemented all price adjustments envisaged in the program. Petroleum prices were increased by 35 percent on average, bread and wheat prices have been decontrolled, and prices of fertilizer and maize meal were adjusted by 11 percent and 22 percent, respectively. Higher producer prices for agricultural products, including maize, were adopted to provide incentive for output expansion and--coupled with a flexible exchange rate--to promote export diversification.

The appropriate pricing policy adopted by the authorities has been enhanced by the assistance provided by the World Bank and other donors in formulating and implementing appropriate sectoral policies. In particular, the mining sector rehabilitation and diversification project now under way and the agricultural sector rehabilitation credit being discussed with the World Bank, for which the required policy measures are already in place, would be of considerable help to the Government's structural adjustment effort. The authorities are also in the process of implementing additional measures to reduce costs and increase efficiency and profitability of ZIMCO with the assistance of the World Bank. To strengthen the financial position of other parastatals, such as NAMBOARD and the Cooperative Unions, the authorities intend to continue the upward adjustment of prices and to take other appropriate measures to ensure their profitability.

Despite the steps taken to address the external imbalance, the medium-term outlook for Zambia's balance of payments position remains difficult and vulnerable to adverse developments in world copper prices. As suggested earlier, there is a clear need for substantial support from Zambia's creditors and donors to make Zambia's intensified adjustment effort successful. This would require generous rescheduling of its debts and meaningful assistance from bilateral and multilateral donors and institutions for a number of years to come. The Fund and the World Bank could play an important role in assisting the country's adjustment efforts--as they do now--both by providing technical and financial support and by encouraging other donors and creditors to extend their support to Zambia. Meanwhile, the authorities remain fully committed to the adjustment program and will undertake all appropriate measures to see it through.

My Zambian authorities are thankful to the staff for the cooperative and comprehensive manner in which they have conducted the review, and they look forward to continue working closely with the Fund in finding solutions to the problems facing their economy.

Mr. Wicks noted that the staff was about to undertake a broad review of the prospects for Zambia's economy. During the previous year, the authorities had demonstrated a commendable determination to implement their economic policies. As a result, the public sector deficit had been halved in 1983, and the external current account deficit as a percentage of GDP had been reduced. The present stand-by arrangement was meant to consolidate that progress, but the external environment had become even more difficult, particularly because of the continued weakness of the price of copper, Zambia's major export. The recent firming--albeit slight--of the price was welcome. To their great credit, the authorities had not allowed the deterioration in the external environment--which was

beyond their control--to lessen their determination to achieve adjustment, and, on the whole, the stand-by arrangement had been implemented resolutely. The authorities had expressed their intention to reinforce their efforts under the 1985 program to mitigate the effects of the deterioration in external conditions, and their perseverance was welcome. The domestic sector had responded to the adjustment measures, particularly those designed to increase the profitability of the mining company and to encourage the development of nontraditional exports.

The weak price of copper was the main cause of the deteriorating external position and the shortage of foreign exchange that had kept the authorities from meeting one of the performance criteria, Mr. Wicks continued. The proposed waiver of the criterion concerned was acceptable. All the other performance criteria had been observed, and the authorities had continued to make progress toward meeting the program objectives.

The authorities had remained within the credit ceilings despite the upward revision of the target for the fiscal deficit, Mr. Wicks indicated. Credit developments should be carefully monitored during the rest of 1984, particularly in view of the anticipated seasonal increase in the demand for credit. In 1985, the authorities should be encouraged to maintain the present tight fiscal and monetary policies, increase their efforts to improve the monitoring and control of public expenditure, and persevere in applying the principle of economic pricing, particularly to NAMBOARD and the Cooperative Unions. The liquidity position of the parastatals had been a major source of the pressure on the public finances, and the authorities should take steps to improve the situation, for instance, by permitting increases in the prices charged by those parastatals.

Externally, Mr. Wicks went on, the observance of the revised end-September 1984 performance criteria and the authorities' intention to resume the scheduled payments into the special account established following the Paris Club agreement were encouraging. However, as the staff had noted, failure to solve the pipeline problem would discourage investors and expatriate workers in Zambia and would raise the price of imports by giving suppliers an incentive to build in a premium for expected payment delays. The authorities should therefore make every effort to allocate scarce foreign exchange efficiently. In that connection, their recognition of the need to reform the import licensing system was welcome.

He was pleased that the authorities intended to maintain the flexible exchange rate policy, Mr. Wicks remarked. Given the high rate of inflation, continued exchange rate adjustment would be needed to improve the profitability of domestic enterprises and to reinforce the incentives for export diversification.

The price of copper would play a crucial role in developments under the 1985 program and for some time thereafter, and the staff and authorities should consider what plans and policies should be adopted if the price remained weak, as seemed likely, Mr. Wicks commented. Despite the

steady pace of the economic recovery in the OECD countries, the supply lines for copper probably would not come under strain, and the 8 percent increase in the copper price forecast for 1985 might well be optimistic.

The next review under the stand-by arrangement should include a comprehensive review of the medium-term prospects for the economy, Mr. Wicks said. In that connection, the description on page 20 of the World Bank's role in solving the longer-term structural problems was welcome. Close cooperation between the Fund and the World Bank in helping Zambia would be crucial.

The next staff report on Zambia should also include a more detailed discussion of the scope for both export diversification and import substitution, Mr. Wicks continued. The supply-side options available to the authorities would be an important part of any medium-term scenario.

Zambia's adjustment program had withstood a severe buffeting in its early months, and the authorities were to be commended for their efforts to stick to the program, Mr. Wicks concluded. Given Zambia's precarious external position, the authorities would have to remain resolute during the rest of the program period if the objectives were to be achieved, and he looked forward to examining the shape of the 1985 program during the next review. Finally, he agreed with the staff appraisal and accepted the proposed decision.

Mr. Goos considered that the authorities were to be commended for their progress in reducing the domestic and external imbalances despite the unfavorable environment, which was caused mainly by factors beyond their control. Still, the staff had concluded that the balance of payments outlook appeared even more serious than at the start of the program. Its analysis of the underlying causes of the deterioration and its suggestions for reinforcing the adjustment policies were appropriate.

That the authorities agreed with the staff on the need to reinforce their policies and intended to redouble their efforts in the coming year was encouracing, Mr. Goos continued. There was room for restraining domestic consumption and boosting savings through various demand management measures, and the planned changes in the systems for trade, payments, and exchange also should help to reduce the existing imbalances. However, such measures were merely complements to the effort to tackle the root cause of the difficulties facing the economy--namely, its nearly exclusive dependence on mineral exports. That effort would take considerable time, and he agreed with the staff that the authorities would have to rely on the continued support of creditors and on concessional aid for a number of years; the active involvement of the World Bank in the country's development and structural adjustment effort was welcome.

The short-term demand managment measures would also make only a limited contribution to overcoming the shortage of foreign exchange, Mr. Goos said. The monetary and fiscal policies were already tight, and

considerable further restraint might well add to the danger of a rapid decline in economic activity and in foreign exchange and budgetary receipts.

The staff's discussion of recent exchange rate developments and the revisions of its projections gave the impression that the latest depreciation of the currency had taken the staff by surprise, Mr. Goos remarked. The staff should comment on the appropriateness of the latest exchange rate action. In response to the growing shortage of foreign exchange, the authorities had aimed at further reducing the real effective exchange rate, but that approach might not prove workable while real interest rates remained negative. In the circumstances, the expectation of further devaluation of the real exchange rate would stimulate additional capital outflows.

The staff had concluded that the recent depreciation of the exchange rate would reduce the imbalance between the demand for, and supply of, foreign exchange, presumably by reducing the demand, Mr. Goos noted. He wondered whether that outcome would not pose the danger of a rapid downward spiral of economic activity. A difficult balance had to be struck between the pressing need to reduce the domestic demand for foreign exchange and the need to preserve productive capacity by making sufficient foreign exchange available to finance imported inputs. Finally, the proposed decision was acceptable.

Mr. Taha commented that the authorities had made considerable progress in consolidating the achievements of their adjustment efforts. Table 3 presented a useful summary of the progress in implementing the Fund-supported program.

All but one of the performance criteria had been observed, Mr. Taha continued. The failure to meet the performance criterion on commercial external payments arrears was unfortunate, but it was due mainly to factors beyond the authorities' immediate control.

He generally agreed with the staff analysis, Mr. Taha said. The proposed decision was acceptable, as the waiver and modification of the performance criterion on external payments arrears were justified. Implementing austerity measures involved difficult economic, social, and political decisions, and the authorities were to be commended for their success. At the same time, they should be encouraged to continue their efforts, particularly as the prospects for the economy in the immediate future and in the medium term were not entirely promising. He was pleased with the indications in Mr. Abdallah's opening statement and in the staff reports of the authorities' determination to maintain the adjustment momentum, and he hoped that the authorities and the staff could soon agree on appropriate policies for 1985.

The authorities' continued commitment to a flexible exchange rate policy was appropriate, Mr. Taha considered. They hoped that the continuation of economic recovery in industrial countries would strengthen the

demand for copper in the near term, but they had appropriately designed contingency measures to mitigate the adverse impact on the economy of any further deterioration in world copper prices.

The present tight fiscal stance should be maintained in 1985, Mr. Taha continued. Timely implementation of fiscal measures would help further to reduce the budget deficit and improve government finances. On the revenue side, the authorities' intention to introduce new tax measures and to improve tax collection was welcome. In addition, they should improve procedures for monitoring and controlling expenditures.

He was pleased that the authorities intended to take steps to mobilize domestic savings, Mr. Taha said. The measures they had already introduced to enhance production incentives and to improve resource allocation were welcome.

The effort to diversify the production base was crucial, given Zambia's overwhelming dependence on a single commodity, Mr. Taha commented. In that connection, the World Bank had a crucial role to play. Successful adjustment would facilitate rapid progress in diversification and growth.

Mr. Joyce commented that the authorities had made a commendable effort to reduce the imbalances in the economy: they had implemented most of the measures in the adjustment program and had met all but one of the performance criteria. Their efforts had been made considerably more difficult by the sharp decline in the world price of copper during 1984. Because Zambia itself could not expect to alter world market conditions for copper, the burden of adjustment must fall most heavily on the domesic economy, unless copper prices continued to firm. In the light of the unfavorable balance of payments prospects, the authorities must maintain their commitment to adjustment and be prepared to implement even more thorough structural adjustment measures if the health of the economy were to be restored. In that connection, the World Bank clearly had a key role to play, and the Fund and the World Bank would have to work closely together.

He was pleased that the authorities had taken steps to regularize their debt service situation and that they intended to accord equal treatment to all their creditors, Mr. Joyce said. He wondered whether Zambia had actually made the required payments to the escrow account established by the Paris Club, and he was worried about the slow progress in the negotiation of bilateral agreements in accordance with the relevant Paris Club minutes. Timely completion of the reschedulings under the Paris Club would encourage fresh assistance.

Given the need to complete the debt rescheduling, the authorities' inability to observe the performance criterion on commercial arrears was a cause for concern, Mr. Joyce went on. The external payment obligations might not be receiving the priority attention they required, thereby discouraging foreign creditors and donors from giving Zambia access to foreign exchange. Still, considerable adjustment had been achieved, and

he hoped that the effort would not be slowed or reversed and was therefore willing to accept the proposed waiver and modification of the performance criterion relating to external commercial arrears. The staff should comment further on the appropriate level of commercial arrears in 1984.

The fiscal performance thus far under the stand-by arrangement had generally been positive, Mr. Joyce considered. The authorities had made a welcome effort to reduce the budget deficit as a share of GDP, and total government revenue, including grants, had been higher than projected. However, the delays in implementing the new minimum import tax and in converting the tax from an f.o.b. to a c.i.f. basis had contributed to the volume of tax revenue being smaller than anticipated. The authorities had made an impressive effort to control expenditures, and he hoped that it would be maintained in the coming period. They had also had success in controlling the growth of credit and money, and the recent increases in interest rates were encouraging, although further increases would be needed if the rates were to reach positive real levels.

The steps taken to increase producer prices for maize, fertilizer, and petroleum products, and the recent elimination of controls on the prices of bread and wheat flour were courageous and encouraging, Mr. Joyce said. The realignment of agricultural prices was particularly significant, as there was an urgent need in Zambia--as well as in other sub-Saharan African countries--to rebuild the agricultural base and to encourage farm production.

The authorities' consistent adherence to a flexible exchange rate policy was welcome, Mr. Joyce commented. In the coming period, they would have to pay more attention to the need for greater liberalization of domestic prices if the currency devaluation were to produce the desired broadening of the export base. Moreover, as President Kaunda had recently stated, the present inflexible exchange and trade system might be impeding the achievement of a stronger external balance. The authorities' intention to liberalize the system further early in 1985 was welcome. He hoped that the President's concern about the functioning of the import licensing system would result in its rapid reform.

In the light of the tightening of economic conditions in Zambia, the staff report could have usefully included a revised medium-term outlook for the economy, Mr. Joyce said. It would have helped Executive Directors to assess both the extent to which actual performance had diverged from the program, and the additional actions that might well be needed, although the serious foreign exchange shortage clearly gave the authorities little room for maneuver, and, as the staff had concluded, they should be urged to adopt additional structural adjustment measures as necessary. Finally, the draft decision was acceptable. The proposed waiver was appropriate, provided that the authorities were prepared to take steps to eliminate the commercial arrears.

Mr. Schneider stated that he broadly agreed with the staff appraisal. The proposed decision was acceptable. Zambia was a textbook example of a developing country that had been kept from making further progress toward achieving a viable balance of payments by adverse external economic conditions and despite the authorities' good intentions and strenuous efforts. Although the authorities had implemented a number of significant adjustment measures, the short- and medium-term outlook for the balance of payments was less favorable than at the start of the program because of the unexpected further decline in copper prices and the high level of interest rates.

It was difficult to give the authorities additional useful advice, Mr. Schneider continued. After all, the Fund had helped them to design a rational program, and they had fully cooperated with the Fund while endeavoring to implement it. Because of recent developments beyond the control of the authorities, there was a danger of a rapid downward spiral of the economy. He hoped that the authorities would be able to avoid it by forcefully implementing the measures envisaged for 1985. It would be particularly important for them to act firmly to accelerate the effort to diversify the economy in order to lessen its dependence on the mining sector.

In the present difficult circumstances, it was imperative that the allocation of foreign exchange be made more efficient, Mr. Schneider commented. The authorities were clearly seeking more appropriate and simpler methods of allocating foreign exchange, and the staff should comment further on their plans to introduce a foreign exchange retention scheme.

The authorities' flexible approach to the exchange rate and pricing policies was welcome and might usefully be applied to interest rates, which were still negative in real terms, Mr. Schneider said. He hoped that the coming debt rescheduling negotiations would be successful, thereby eliminating an element of uncertainty about Zambia's difficult external situation. He agreed with the staff that "creditors both within and outside the Paris Club also will need to continue to be more understanding." Finally, in the light of its close cooperation with the Fund, Zambia deserved Fund assistance in finding a long-term solution to the problems facing the economy.

Mr. Polak said that the proposed decision was acceptable. Although faced with unexpectedly low copper prices and unexpectedly large debt service payments, the authorities had continued to adhere to the program. They should be urged to continue to do so in the coming period, when orderly adjustment along the lines set out in the program would be imperative to prevent the collapse of domestic production.

The original projection of zero economic growth in 1984 had not changed, Mr. Polak noted, but the small volume of total imports might well cause real GDP to fall. He wondered whether unchanged copper prices also might cause a further decline in real GDP in 1985. The staff had

cautioned that further import reductions could cause domestic production to collapse, and the fact that the balance of payments projection for 1985 assumed higher copper prices but no room for increased imports--even in nominal terms--was worrying. Should copper prices remain at the present level, the effort to maintain imports would require the authorities nearly to cease servicing the foreign debt.

He had been increasingly uncomfortable with staff forecasts of prices for individual commodities and world indices--such as those in the World Economic Outlook--expressed in terms of U.S. dollars alone, Mr. Polak said. Such forecasts seemed an amalgam of two separate components--namely, an analysis of supply and demand conditions in the major countries, and the exchange rate for the dollar vis-à-vis other currencies or the SDR. However accurate the staff analysis of supply and demand conditions might be, its projections could turn out to be quite inaccurate if there were a sharp change in the value of the dollar. If the dollar rose, prices of internationally traded commodities must ceteris paribus decline in terms of dollars, the precise extent of the fall depending on certain factors relating to supply and demand conditions. The staff should seriously consider whether forecasts expressed in SDRs would not be more accurate than forecasts in dollars. The Economist already published its indices of raw material prices in dollars, sterling, and SDRs.

Given both the importance of the price of copper for Zambia, and the repeated setbacks from unexpected declines in the price and from expected increases that had not materialized, the next staff report should include at least one scenario that was not based on an increase in the price, Mr. Polak remarked. A further decline in the price was unlikely, but it was insufficient to base the medium-term evaluation of the economy entirely on sizable price increases. The staff could usefully comment further on the medium-term need for debt relief on the assumption that both imports and copper prices remained at the present level. Similarly, information on the total debt, including debt relief in the form of additional credits or grants, would be helpful. It would probably lead to the conclusion that debt service was to some extent a function of developments in the price of copper.

The staff had urged the authorities to make further progress in improving the allocation of foreign exchange and in reducing the commercial arrears, but it had said relatively little about possible concrete steps in those directions, Mr. Polak remarked. He wondered whether the staff or the authorities had any specific solutions in mind--for instance, auctioning of import licenses.

Mr. Flamant said that he agreed with Mr. Schneider that Zambia was a good example of a country whose internal and external economic and financial situation had deteriorated during the previous two years despite strenuous adjustment efforts by the authorities at great social cost. The unfavorable developments had occurred mainly because of the deteriorating world market conditions for copper, Zambia's main export commodity. Zambia's experience was evidence of the fragility of the present world

economic recovery: the recovery was still threatened by several factors that had adversely affected the world price for copper. In a recent departmental memorandum, the staff had concluded that "copper prices in recent months have not reflected the improving supply-demand balance because of the following: first, the appreciation of the U.S. dollar; second, increases in real interest rates that have only recently been reversed; third, uncertainty related to the possibility that the United States would impose import restrictions on copper; and, fourth, keen competition among exporters who still have large supplies to market."

Given the continuous decline in the terms of trade, which was beyond the control of the authorities, the policy response had been courageous and commendable, Mr. Flamant continued. The exchange rate had been repeatedly adjusted to help the financial position of the copper mining sector. At the same time, the adjustments had improved the competitiveness of other sectors, particularly agriculture, which had been a desirable development because agricultural output should be the focal point of the effort to diversify the economy away from copper.

Fiscal and monetary policy had been consistent with the program objectives, Mr. Flamant remarked. Subsidies had been reduced through a number of sizable increases in the prices of consumer products, including basic staples, such as maize meal. Those measures had had a strong supply-side element, as they had permitted significant increases in agricultural producer prices. However, the desired supply-side response had been limited by the acute shortage of foreign exchange owing to the depressed level of export revenues. Shortages of imported inputs, raw materials, and spare parts had hampered the normal functioning of the economy. For instance, the operations of the Tazara, a railroad vital for copper exports, had had to be halted recently for several days because of a lack of foreign exchange to pay for fuel.

In the present difficult circumstances, the authorities were unlikely to be able to implement quick-acting remedies, Mr. Flamant commented. In the absence of a strong recovery in the copper market, as seemed likely, the authorities apparently had no alternative to continuing to implement adjustment policies. That effort would have to be bolstered by multilateral and bilateral external assistance, either rescheduling or balance of payments support. Close cooperation between the World Bank and the Fund was called for. Finally, he had no difficulty in accepting the proposed waiver of the performance criterion on external commercial payments arrears, and the proposed decision should be approved.

Mr. Dallara indicated that Zambia's economic situation remained precarious, owing largely to the low copper prices. While there was little that Zambia or any other individual country could do to affect the price of copper, it could reduce its dependence on copper exports. The authorities, with the support of the Fund, had in fact been making a strong effort to do so, but additional measures would be needed both to contain imports and to stimulate further production of nontraditional exports. The shortage of foreign exchange had strained the import

licensing system, as the issuance of licenses during the second quarter of 1984 had been based on an anticipated increase in the price of copper, and Zambia had had no extra foreign exchange to cover that miscalculation.

Zambia itself must continue to assume the final responsibility for its economy, Mr. Dallara considered. Assistance from the international community obviously could not indefinitely compensate for weak copper prices. The increase of SDR 35 million in donor transfers following the latest Consultative Group meeting had not completely offset the estimated SDR 37 million reduction in export revenues in 1984. He was pleased that the authorities had met the performance criteria relating to the credit ceilings and that they were continuing to manage the exchange rate flexibly. Their performance in other areas was also impressive, particularly in the circumstances of Zambia. Hence, the proposed waiver and modification of the performance criteria on relating to external commercial arrears was acceptable. Unfortunately, however, the implied increase in commercial arrears would inevitably undermine the effort to restore Zambia's creditworthiness; there had already been occasional delays in opening letters of credit for oil shipments. The authorities should be encouraged to introduce measures in 1985 to eliminate the increase in arrears in 1984.

The staff should commment further on the authorities' efforts to diversify agricultural output, Mr. Dallara remarked. In addition, he wondered whether the staff felt that with the ongoing reform of the parastatal sector, the private sector had additional room to expand its activities. In that connection, continued flexible management of the exchange rate and automatic passing through to domestic prices of the effects of exchange rate changes should send the price signals needed to guide investment and production; he wondered whether the staff had yet drawn any firm conclusions on the efficiency of that process. The recent decontrol of bread and wheat flour prices and increases in petroleum product prices were welcome, but a more complete liberalization of domestic prices would eliminate any lingering disincentives to production and would eliminate the need for subsidies to the parastatals; in 1984, those subsidies were expected to exceed the original estimate by about K 20 million.

He did not agree with the staff that the increase in the interest rate on deposits to 17.5 percent was adequate, Mr. Dallara said. After all, the rate of inflation was much higher--about 25 percent. Finally, the proposed decision was acceptable.

Mr. Lindå commented that, despite the authorities' determined efforts, recent economic developments in Zambia had been disappointing. The significantly weaker than anticipated copper market and larger than expected debt service payments had caused a severe shortage of foreign exchange that threatened overall economic performance.

The volume of copper exports had been consistent with the program estimates, but the price trend again had underscored the vulnerability of Zambia's economy to external factors, Mr. Lindå continued. The authorities were aware of the need to diversify the export base, and the prospects for

doing so, particularly in agriculture, were promising. In that context, continuing the flexible exchange rate and pricing policies would be helpful.

Even after the necessary policies were in place, the needed structural adjustment could be accomplished only in the long term, Mr. Lindå commented. Because of the nature of the country's problems, and because Zambia had been a prolonged user of Fund resources in the upper credit tranches, the Fund's role in Zambia in the coming period could only be a rather limited one; therefore, the country would require extensive official development assistance for a number of years and continued help from the World Bank. Close cooperation between the Fund and the World Bank would be of great importance. Finally, the proposed decision was acceptable.

Mr. Haque said that he broadly agreed with the staff appraisal. Despite the substantial deterioration in the terms of trade, the program appeared to be broadly on track. All but one of the performance criteria had been met, and demand management had been significantly improved. Those accomplishments, together with the measures and performance criteria for the coming period, indicated the authorities' commitment to adjustment. However, the task in the coming period was expected to be difficult because of the serious problems that were likely to continue to face the economy. Structural changes, as well as careful demand management, would be needed to restore growth in the medium term. The authorities were attempting to diversify the economy to reduce its dependence on mineral resources, the reserves of which were being depleted and the world market for which was weak. Those efforts should be supported by an increase in competitiveness and by further measures to streamline and improve the efficiency of the public and parastatal sectors.

Mainly because of the continued weakness in copper prices, the balance of payments outlook for the rest of the decade appeared even less promising than at the start of the program, Mr. Haque noted. The authorities had clearly recognized the need to intensify the ongoing adjustment effort. The flexible exchange rate policy had helped to maintain some of the profitability of the mining sector, despite the decline in export prices, and it had acted together with the recent increases in producer prices, especially in agriculture, to reinforce incentives for export diversification. However, the depreciation of the currency had increased outlays on food subsidies, thereby causing government expenditures in 1984 to grow more rapidly than had been expected. As a result, the budget deficit was likely to exceed the initial projections. The performance criterion on bank borrowing by the Government was to be observed by increasing borrowing from nonbank and foreign sources. In the circumstances, the removal of the control on the prices of bread and wheat flour, and the increase in the prices of petroleum products, bringing them closer to market-determined levels, were welcome. Further control of expenditure would be achieved as the efficiency of the parastatal sector was increased and as a result of the examination of government employment that would be undertaken in 1985.

Given the high rate of inflation, the authorities' decision to maintain a tight monetary policy was appropriate, Mr. Haque continued. They had also appropriately restrained credit to meet the program ceiling on the growth of net domestic assets. To that end, and to encourage domestic savings, interest rates had again been increased. However, as the rate of inflation had not yet responded to the tightening of monetary policy, interest rates remained negative in real terms.

Foreign exchange was likely to remain scarce, as Zambia's debt burden remained large and the prospects for copper prices had not significantly improved, Mr. Haque remarked. The authorities' intention to improve the system of import licensing in early 1985 was therefore encouraging, as it should allocate scarce foreign exchange to the most productive and essential uses without significant administrative cost. He agreed with previous speakers that the staff should be cautious in making assumptions about the behavior of copper prices for projections of the performance of the external sector. A lower than anticipated copper price had contributed to the difficulties in implementing the 1983 adjustment program and was the reason for the proposed modification of a performance criterion. Given that experience, he wondered whether consideration had been given to including performance criteria contingent upon outcomes in the copper market. In addition, future reports should contain an explanation of the assumption concerning the behavior of copper prices. Finally, the proposed decision was acceptable.

Mr. Orleans-Lindsay stated that he broadly agreed with the staff appraisal. The proposed decision was acceptable.

The authorities had obviously been implementing their adjustment policies for 1984 under very difficult conditions, including an unfavorable external environment, Mr. Orleans-Lindsay commented. The adjustment program contained a number of important and far-reaching policy changes, and overall performance had been impressive. The continued flexible exchange rate policy, which was designed to accelerate the structural changes needed to reinforce the incentives for export diversification and to ensure the continued profitability of the mining sector, was particularly commendable. However, recent movements in the exchange rate had caused some problems and raised the technical questions mentioned by previous speakers.

He shared the concern of other Executive Directors about Zambia's deteriorating external position owing mainly to the decline in copper export prices, Mr. Orleans-Lindsay remarked. The recent firming of copper prices was encouraging, but studies suggested that there would continue to be uncertainty in the world copper market for a long period. The shortage of foreign exchange, the main cause of Zambia's present financial difficulties, had kept the authorities from observing the performance criterion on external obligations for end-September 1984. The authorities' efforts to reinforce their adjustment policies in order to keep the program on track were welcome. Given the adverse developments

in world copper prices, Zambia's creditors and donors should be urged to continue providing financial assistance for the country's adjustment effort.

The staff representative from the African Department said that the staff would begin negotiations on a 1985 program in December. The authorities had paid $5.6 million into the escrow account in August 1984 and, while no further payments had been made, the Governor of the Central Bank had assured the Chairman of the Paris Club that they would be.

The staff had told the authorities that the pipeline of commercial arrears should be regularized, so that normal relations with suppliers could be restored and disincentives to expatriates working in Zambia and foreign firms operating in the country could be eliminated, the staff representative remarked.

A further reduction in the volume of imports might well have serious adverse consequences for the economy, the staff representative commented. During the coming discussions, the staff would encourage the authorities to provide every possible incentive to increase exports.

He agreed with Mr. Goos that negative real interest rates significantly undermined the usefulness of the real depreciation of the exchange rate, the staff representative from the African Department commented. The staff would not wish to leave any impression that it felt that the present, heavily negative interest rates were adequate; they were a strong incentive for capital exports. Finally, the staff had not been surprised by the slight acceleration of the rate of depreciation of the exchange rate since September 1984.

Mr. Abdallah commented that Executive Directors apparently appreciated that the deteriorating external environment had had an even greater adverse effect on the adjustment effort than had been anticipated when the program had been prepared. The authorities hoped to increase the negative real interest rates by containing inflation, rather than by adjusting the rates themselves, although they were worried that positive real rates could discourage appropriate borrowing.

Diversifying exports was the most serious challenge facing the authorities, Mr. Abdallah remarked. The authorities were fully aware that they needed to act quickly to reduce the country's reliance on copper exports. During discussions in September 1984, the Finance Minister and the Governor of the Central Bank had stressed their determination to exploit the vast potential of the agricultural sector. They realized that copper prices were likely to remain low, and that the copper reserves would be depleted in about 15 years.

Having recognized that the parastatal sector was inefficient, the authorities were encouraging the private sector to play a greater role in the economy, Mr. Abdallah said. The international community should be

encouraged to support the authorities' various efforts to improve economic performance; the role of the Fund in the future would have to be relatively limited, as the authorities had already received access to resources in the upper credit tranches. The World Bank staff had been working closely with the Zambian authorities, particularly on the export diversification projects. He was confident that the authorities would continue to work with the Fund to solve the problems facing the economy.

The Executive Board then approved the following decision:

1. Zambia has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Zambia (EBS/84/135, Sup. 2, 7/20/84), which entered into effect on July 26, 1984, and in accordance with the letter from the Minister of Finance dated June 1, 1984 attached thereto.

2. The letter of the Minister of Finance of Zambia dated October 31, 1984, shall be annexed to the stand-by arrangement for Zambia and the letter dated June 1, 1984 shall be read as supplemented and modified by the letter of October 31, 1984.

3. The Fund decides that, notwithstanding the fact that external commercial payments arrears have not been limited as contemplated in paragraph 4(a)(1) of the stand-by arrangement for Zambia, Zambia may proceed to make purchases under the stand-by arrangement.

4. The understandings referred to in paragraph 4(a)(1) of the stand-by arrangement for Zambia, relating to external commercial payments arrears, shall be those for end-December 1984, as described in paragraph 5 of the letter of the Minister of Finance of Zambia dated October 31, 1984.

5. The Fund and Zambia have concluded the review pursuant to paragraph 4(c) of the stand-by arrangement for Zambia and paragraph 6 of the letter of June 1, 1984 attached thereto. The Fund finds that no understandings in other respects are necessary.

Decision No. 7847-(84/169), adopted
November 26, 1984

3. NIGER - STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on Niger's request for a one-year stand-by arrangement equivalent to SDR 16 million that would enter into effect on December 5, 1984 (EBS/84/221, 10/29/84; and Cor. 1, 11/21/84).

The staff representative from the African Department made the following statement:

As mentioned in the staff report on Niger's request for a stand-by arrangement, World Bank missions were expected to visit Niamey in October 1984 to review with the authorities their investment program and the reform of the public enterprise sector. These missions have recently returned to Washington. The Fund staff received the following communication from the World Bank staff:

1. As part of the preparation of a structural adjustment program for Niger, a World Bank mission visited Niamey in October 1984 to review the Government's development strategy and its medium-term investment program, including its recurrent cost implications. The mission also reviewed the ongoing as well as new investment projects included in Niger's 1984/85 public investment budget and concluded that the composition and level of the budget is generally appropriate and in line with the Government's commitments made under the stand-by arrangement negotiated in August. In general, the World Bank was in agreement with the choice of investments which are focused primarily in the productive sectors (60 percent) and rural water supply (26 percent). Moreover, the program shows a movement away from large infrastructure investment and emphasizes rehabilitation to ensure a more efficient use of already existing facilities. However, the World Bank is still reviewing with the authorities the transport sector investment program, arguing that the emphasis should be put more on road maintenance rather than on the construction of new roads and that any new roads to be constructed should have an acceptable economic rate of return. Further exchanges of views between the authorities and the World Bank are expected to take place later this year with a view to formulating an appropriate investment program for the transport sector in the context of a structural adjustment program.

2. A second World Bank mission visited Niger in October to define with the authorities a comprehensive reform program for the public enterprise sector. The mission had extensive discussions on macroeconomic, institutional, and legal issues as well as the overall restructuring of the sector including rehabilitation, privatization, and liquidation of individual enterprises. The mission concluded that there is a genuine commitment on the part of the Government to reform the parastatal public sector as evidenced by the specific measures undertaken under the stand-by arrangement, the Government's initial decision to fully privatize 14 enterprises, and the creation of a special ministry to supervise the public enterprise sector. Substantial progress was made during the mission toward the formulation of

the various elements of a medium-term parastatal reform program to be supported by an IDA Structural Adjustment Credit and a Public Enterprise Rehabilitation Project.

Mr. Alfidja made the following statement:

The financial and economic performance of Niger under the stand-by arrangement approved by the Executive Board on October 4, 1983 has been satisfactory in many respects. The budgetary deficit (on a commitment basis) has substantially decreased, inflation has fallen, the current account deficit has also been reduced--albeit slightly--the financial position of several major public enterprises has improved, and the domestic payment arrears have been sharply reduced. So far, all performance criteria have been observed and indications are that those set for end-September 1984 would also be met. Instrumental in these achievements were the difficult and courageous demand management measures taken by the Nigerien authorities, especially in the fiscal and the public enterprise sectors.

Concerning the fiscal sector, in line with the recommendations of the National Commission on the Tax Reform and of the Fund staff, the Government took measures aimed at increasing revenue and reducing expenditure. On the revenue side, the base of taxes on income and profits as well as of import duties was broadened, with the applicable rate raised in some instances. The payment scheme for taxes on industrial and commerical profits was modified in order to improve the yield. Petroleum products were also subject to higher levies. However, owing to the closure of Nigeria's border, the drought, and a decrease in the demand for uranium, the revenue expansion was below expectations, prompting the Government to reduce spending further. As a result, the overall fiscal deficit was broadly in line with the program projection.

The financial position of a number of public enterprises improved, reflecting the effects of the rehabilitation measures taken during the program year and the discharge by the Government of its payment arrears vis-à-vis these companies. The Government intends to pursue its efforts to restructure the public enterprise sector. In this respect, the Nigerien authorities are preparing a comprehensive reform program, which could be supported by the World Bank under a structural adjustment credit and public enterprise rehabilitation loan. In the meantime, on October 1, 1984 measures aimed at further improving the financial position of the state grain agency (OPVN) and the telecommunication agency (OPT) were taken. In particular, the retail prices of OPVN were adjusted to reflect market conditions, and a system of tenders

and bids for wholesale purchases and sales of millet and sorghum were introduced. The tariff of telephone services provided by the OPT was also increased.

The objective of a resumption of positive economic growth after three consecutive years of decline in real GDP, as envisaged in the proposed program, should be viewed in a medium-term framework. In this context, the Government intends to continue in 1985 the reorientation of the investment program toward directly productive projects, which began in 1983. The rehabilitation of the existing economic infrastructure will also retain the attention of the Nigerien authorities. In this vein, appropriate resources will continue to be devoted to the maintenance of the road network. The present policy of tight scrutiny of new investment proposals (with World Bank assistance) will be maintained.

In support of this investment policy, other supply-oriented policies designed to ensure a better allocation of resources are being put in place. The decision to terminate, effective October 1, 1984, the OPVN's monopoly on the importation and marketing of cereals and SONARA's monopoly on the export of cowpeas forms part of these policies. While awaiting the preparation of a more detailed long-term restructuring program for the public enterprise sector, the Nigerien authorities intend to focus attention on seven key state corporations.

Regarding public finances, the tax measures in the 1984/85 budget include setting up a more effective system of assessing properties, improving the coverage of the personal income tax through the computerization of taxpayer rolls, and simplifying the system for assessment and payment of the industrial and commercial profit taxes. On the expenditure side, the Government will continue to restrain total spending growth by placing strict ceilings on administrative expenditures, freezing wages for the third consecutive year, and limiting new hiring of government workers. Investment expenditure is also expected to remain broadly unchanged from its 1983/84 level.

On the external front, the current account deficit is expected to decrease further, to 2.8 percent, in 1985. The Government is still preoccupied by the high level of the country's external debt service ratio. In this regard, cooperation between creditors and Niger in order to find appropriate solutions to the country's debt problem is crucial.

To conclude, I wish to stress the Nigerien authorities' commitment to undertake the necessary adjustment measures in order to restore the viability of the economy. They are aware that despite the progress made so far, the realization of this objective will require further efforts over time.

Despite the effects of adverse factors beyond the Government's control, such as the closure of the Nigerian border, the persistent drought, and the low demand for uranium, which are frustrating efforts to restore internal and external balance in the economy, the Government is determined to consolidate the progress achieved under the present program. In this vein, they are formulating, in close cooperation with the World Bank, a medium-term recovery program that could gain further support from the Fund.

The staff representative from the Treasurer's Department noted that paragraph 3 of the proposed stand-by arrangement stated that "purchases under the proposed arrangement will be made equally from ordinary and borrowed resources." That statement reflected Niger's outstanding position in the Fund, including a purchase of SDR 2.8 million still available under the current stand-by arrangement, which would expire on December 4, 1984. Niger would be entitled to make that purchase after the staff had certified that the performance criteria for the relevant period had been met; the staff expected that the purchase would be made within the coming two weeks. However, if for some reason Niger did not make that purchase, its position in the Fund would be such that the purchases under the proposed stand-by arrangement would be financed entirely with ordinary resources. In that event, an amended text of the new stand-by arrangement would be submitted for the Executive Board's approval on a lapse of time basis.

Responding to a question by Mr. Alfidja, the staff representative from the Treasurer's Department said that the possible amendment he had mentioned would in no way be meant to penalize Niger. The staff had not yet received the data necessary to determine whether or not the country had met the performance criteria under the present stand-by arrangement. The staff expected to receive the data before the expiration of the present arrangement and, subject to the verification of the observance of the performance criteria, to permit Niger to make the purchase. However, if the drawing could not be made, the proposed financing under the new stand-by arrangement would not bring the Fund's holdings of Niger's currency in the upper credit tranches above 100 percent of quota, and there would be no need for a mix of financing under the new arrangement.

Mr. Blandin stated that he supported Niger's request for a stand-by arrangement. The present stand-by arrangement had been successfully implemented, and the new one appeared well tailored to the country's adjustment effort and appropriately included a number of supply-oriented measures.

The achievements under the existing stand-by arrangement, which would expire on December 4, 1984, had been impressive, Mr. Blandin remarked. The authorities were to be commended for their strong commitment and adherence to the adjustment program. Their accomplishments were particularly notable given the adverse effects of the closure of the border with Nigeria and the severe drought. Those developments were the main cause

of the 3.8 percent decline in real GDP in 1984--the third successive year of negative GDP growth--and they had made the required demand restraint particularly painful. However, the budget deficit had been reduced from 7.3 percent of GDP to 4.7 percent on a commitment basis, and the bulk of the domestic payments arrears had been eliminated; and those accomplishments had clearly helped to keep domestic credit under control. On the external front, the planned reduction in the current account deficit in 1984 would not be achieved because of the exogenous factors he had mentioned, but the deficit probably would remain less than 4 percent of GDP and could be easily financed through debt relief and access to Fund resources.

The most worrying development under the present stand-by arrangement was the sharp decline in government investment, although most of the cuts had affected nondirectly productive investments and apparently had not posed a genuine threat to the resumption of growth, Mr. Blandin remarked. The emphasis under the proposed stand-by arrangement on supply-side measures was appropriate.

Given Niger's dependence on, and the poor prospects of the world market for, uranium, there was an urgent need to diversify production away from uranium, Mr. Blandin said. To that end, resources would have to be allocated on a sound basis: priority should be given to productive activities, particularly in the agricultural sector. In that connection, the 1985 program seemed satisfactory; it included a number of measures designed to trigger a sizable supply response. The liberalization of the pricing and marketing of cereals, the abolition of the monopoly of the Office des Produits Vivriers du Niger, and the liberalization of the exportation of cowpeas should provide increased incentives to farmers. Those measures were not only necessary, but also difficult and courageous.

The authorities planned to make considerable progress in the public enterprise sector, Mr. Blandin continued. They had decided to reform the public enterprises and, to that end, difficult decisions would have to be made concerning, for instance, the classification of public enterprises into three categories, one of which would encompass enterprises that were to be liquidated.

The authorities had agreed to reorient the public investment program to give priority to completing ongoing viable projects and new projects in productive sectors, Mr. Blandin noted. The World Bank had a particular interest in that effort and was considering Niger's application for structural adjustment credit. That the World Bank's approval would probably be delayed until the end of 1985 was regrettable; the period of the delay should be used to make progress in preparing the 1986-88 public investment program.

The authorities' substantial adjustment effort had been partially offset by adverse factors beyond their control, Mr. Blandin remarked. They would undoubtedly have to make further efforts in close collaboration

with the Fund and the World Bank. In the light of the particular circumstances of Niger, including the authorities' strong commitment to adjustment, a multiyear arrangement might be the best way of tackling the problems facing the economy. In particular, it would give the Fund flexibility to respond to possible future adverse developments, such as the continued closure of the border with Nigeria.

Mr. Schneider stated that he accepted the proposed decision. Despite unforeseeable adverse external developments, Niger had been able to make a number of corrections in the economy under the 1983/84 adjustment program: the operations of key parastatals had been significantly improved; the budgetary and external current account deficits had been reduced; the rate of domestic credit expansion had been contained; and the rate of inflation had been cut. The shift in investment to the productive sector was particularly commendable. However, real GDP had continued to fall--by 3.8 percent in 1984--due mainly to adverse weather conditions. Of course, any country that was dependent on developments in mineral prices and weather conditions had a limited ability to restore a reasonable rate of growth and to improve the external current account balance.

Still, Mr. Schneider continued, the long-term balance of payments outlook showed that if the price of uranium were to increase by about 27 percent between 1984 and 1990, and if weather conditions were to return to normal, Niger could achieve a viable balance of payments position by 1988 and an annual rate of economic growth of about 3 percent. The gradual restoration of a viable balance of payments position would require the continuation of the strict demand management policies, and exceptional external financing would be needed to cover the resource gap expected to appear in 1986-88. The orientation of the proposed program in general and of the supply and demand measures in particular seemed appropriate. He was pleased that the program included a number of structural measures to improve the allocation of domestic productive resources.

Niger was a good example of a country that could benefit from closer cooperation between the Fund and the World Bank, especially in the areas of public enterprises and public investment, Mr. Schneider considered. The information provided by the staff on the results of World Bank missions since October 1984 was welcome.

The authorities were to be commended for their efforts to achieve a comprehensive structural reform of the public enterprise sector, improved resource allocation, and a reduction in financial imbalances, Mr. Schneider said. New tax measures and further containment of public expenditure would be needed to sustain the adjustment of the budget deficit. The recently introduced value-added tax and the computerization of the application of tax rules had significantly improved the tax structure and administration. As the staff has noted, successful implementation of the value-added tax would require well-trained personnel and an efficient system of tax administration.

Mr. Grosche remarked that Niger's encouraging progress under the present stand-by arrangement should pave the way for the authorities to move closer toward a viable balance of payments position under the proposed stand-by arrangement. The progress was particularly commendable because it had been made despite adverse exogenous factors, particularly the drought and the closure of the border with Nigeria.

The adjustment effort under the present stand-by arrangement had been based mainly on demand management measures, Mr. Grosche noted. Imports and public investment in particular had been drastically curtailed. The restraint had been necessary, but further heavy reliance on demand-oriented measures could impair the growth prospects of the country and negatively affect tax revenues and the budget. The decline in tax revenues in 1984, despite the implementation of tax reform measures along the lines recommended by the staff, was a cause for concern, and the equal emphasis in the new program on demand management measures, on the one hand, and on supply-side measures to achieve economic recovery, on the other, was welcome.

The objectives under the new program seemed ambitious, Mr. Grosche continued. The desired resumption of positive real growth, deceleration in the rate of inflation, and further reduction in the current account deficit could be achieved only if the performance of the public enterprises were improved and public investment policy were reoriented.

The reform of the public enterprises should be carried out with determination, Mr. Grosche went on. The reform was still in the planning stage, although a recent World Bank mission had concluded that the authorities were generally committed to it, and that there had been progress in formulating a medium-term program. He hoped that the program would be implemented as quickly as possible.

If the adjustment effort were to succeed, the authorities would have to maintain a sound public investment policy, concentrating investment on productive sectors and maintaining investment at a level compatible with the availability of resources, and he was pleased that the World Bank had approved the amount of investment planned for 1984/85, Mr. Grosche continued. Since Niger had been closely cooperating with the World Bank for some time, he had been surprised to learn that, until recently, the Government's development policy had exceeded the country's real and financial capacities. The drastic cut in public investment in 1983-84--46 percent--underscored the need to improve the cooperation between the Fund and the World Bank.

The authorities apparently intended eventually to seek an extended arrangement, Mr. Grosche commented. According to the balance of payments projections on page 13, substantial financing gaps were expected to appear in 1986-88, and exceptional financing would be required to cover them. In addition, in 1985-90, Niger would have to make repurchases in respect of purchases from the Fund. Given the problems facing the economy, the Fund would probably have to remain involved in the country for some time,

but the Fund should not necessarily approve an extended arrangement only to ensure that the repurchases could be made or because Niger lacked alternative means of financing. The Fund should try to help Niger solve its balance of payments problems as quickly as possible and, to that end, an additional stand-by arrangement and, if necessary, a further follow-up arrangement would be preferable to an extended arrangement. A series of stand-by arrangements would enable the Fund to remain closely involved in Niger and to advise the authorities on means of dealing with the most pressing problems facing the economy. Finally, the proposed decision was acceptable.

Mr. Leonard considered that the authorities had performed well under the stand-by arrangement. Despite unexpected problems, they had met all the performance criteria and had reduced the economic imbalances and structural rigidities. In so doing, they had shown a commendable resourcefulness and commitment to adjustment.

The 1984/85 program should enable the authorities to make further progress toward restoring a viable balance of payments position by 1990, Mr. Leonard commented. Fund assistance could play a vital role in the effort to strengthen Niger's financial position, but continued concessional and nondebt creating financing would also be required, and the authorities would have to remain committed to adjustment over a long period.

The staff's medium-term outlook for the economy seemed realistic, but it was highly sensitive to changes in the underlying assumptions, Mr. Leonard remarked. Even if actual developments were as favorable as the staff had projected, the scope for increasing per capita real income to an acceptable level would be very limited. Economic growth was projected to increase moderately--3 percent per year--and considerable resources would be needed to service the debt. Indeed, the staff had projected that, even with debt relief, public debt service from 1984 onward would be only slightly less than net public capital inflows; and net private capital inflows in that period would be consistently negative. Careful economic management and generous concessional financing and other assistance would obviously be required.

The proposed stand-by arrangement was equivalent to only 47.5 percent of Niger's quota, Mr. Leonard observed. Although the amount was small, it seemed appropriate for two reasons: Niger's balance of payments position would continue to be precarious for at least the coming several years; and Niger's financial requirements would be large in relation to its quota. He hoped that further debt relief and concessional financing would meet a substantial portion of the financing need, but continued Fund assistance would probably be required for some time, and it seemed best for Niger to avoid exhausting its access to the Fund forthwith. It was important to bear in mind that, even with debt relief, the debt servicing ratio would probably continue to be high through 1990; therefore, care should be taken to avoid substantially increasing Niger's debt to the Fund at the present stage.

The restraint on government expenditure thus far in 1984 was appropriate, particularly in the light of the revenue shortfall, Mr. Leonard commented. The reduction in arrears was welcome, particularly as it had helped to strengthen the financial position of parastatals. Fiscal restraint would continue to play a key role in containing liquidity expansion and in eliminating arrears, and he was pleased with the determination to maintain such restraint reflected in the proposed stand-by arrangement. The emphasis on controlling administrative expenditure, transfers to public entitites, and the public wage bill was welcome, particularly in view of the country's highly vulnerable financial position and the uncertain outlook for the economy. The authorities should continue both to keep the level of public investment compatible with available concessional financing and to allocate available resources as efficiently as possible. The World Bank's ongoing assessment of the appropriateness of the level and composition of public investment, and the establishment of a medium-term investment program were welcome.

He hoped that the tax measures being introduced would help the Government to meet the revenue target for 1984/85, Mr. Leonard said. However, in 1983/84, revenues had actually fallen, despite the introduction of the new measures recommended by the Fund. The staff should comment further on the reason for the decline. Had the new measures been deficient in some way, and were the results likely to be better in the coming period?

In concluding, Mr. Leonard said that he accepted the proposed decision and agreed with the staff that further efforts to implement price reforms and to reduce the monopoly powers of parastatals would be essential.

Mr. Nimatallah stated that the proposed decision should be approved. Niger was in a good position to undertake medium-term adjustment leading gradually toward balance of payments viability by the late 1980s. It would be unfortunate if the adjustment process in Niger were to be interrupted, and the proposed stand-by arrangement was therefore welcome.

He was pleased that, on the supply side, the program aimed at improving, inter alia, the position of public enterprises, Mr. Nimatallah commented. To that end, the recent establishment of a permanent working group on reform of the public enterprise sector was helpful. The investment program for 1985 was to be consistent with the availability of resources and the absorptive capacity of the country, and he hoped that, with the help of the Fund and the World Bank, it would enable the authorities to achieve sustainable economic growth.

On the demand side, he hoped that most of the planned reduction in the budget deficit could be achieved through an increase in government revenues rather than through a further contraction in expenditure, particularly on investment, Mr. Nimatallah continued. Indeed, investment expenditure in 1985 should not be below the level in 1984 in real terms. The rate of inflation was fairly low, and at its present stage Niger could afford to spend a little more on capital formation in order to expand its

absorptive capacity. However, he agreed that the overall rate of monetary expansion should be reduced and that the authorities should continue to maintain a prudent external debt management policy.

The authorities faced difficult problems because of the drought and the closure of the border with Nigeria, and they were to be commended for the difficult decisions they had made and were expected to make in implementing the 1985 program, particularly in the areas of the budget and investment, Mr. Nimatallah remarked. As the staff had noted, while the authorities were determined to implement the program, much would depend on the return of more normal weather conditions.

In response to the adverse weather conditions in the Sahel countries, including Niger, Saudi Arabia had made about $100 million in grants to those countries to finance the drilling of wells for water and the extension of irrigation canals, Mr. Nimatallah said. In addition, Saudi Arabia had recently announced a further grant of $30 million to those countries for drought relief. Although Niger had been covered by those grants, it had also been given a separate grant of about $14 million. The Niger authorities had been using those resources effectively, and he hoped that improved weather conditions and the new stand-by arrangement would enable the authorities to make further progress in adjusting the economy.

Mr. Finaish remarked that in Niger, as in many other developing countries, the early 1980s had been marked by a deterioration in economic conditions, as economic growth had given way to declines in output, and domestic and external financial imbalances had increased considerably; and adverse exogenous developments, such as the decline in demand for exports and the deterioration of the terms of trade, had played a significant role. The authorities were to be commended for not having taken too long to recognize the need for adjustment in response to those developments and to other financial and structural imbalances in the economy. Furthermore, once the process of adjustment had been started, the authorities had shown commendable determination and adaptability.

The measures contained in the 1983/84 stand-by arrangement had been effectively implemented, and thus far all the performance criteria had been observed, Mr. Finaish continued. Despite further adverse exogenous developments, the fiscal and external imbalances had been significantly reduced from the high levels of 1982, inflation had decelerated, and the elimination of domestic arrears had exceeded the program target. Measures had been adopted to improve and extend the tax system and to control expenditures, and credit policy had been tightened. In the public enterprise sector, where serious financial problems had emerged, the position of many enterprises had improved as a result of both the settlement of arrears owed to them and the more appropriate pricing and management policies.

The growth performance had been much less encouraging, Mr. Finaish went on. The estimated fall in GDP in 1984 by nearly 4 percent, compared with the projected moderate increase, was a reflection of the emergence

of drought conditions and of the sharp drop in public outlays required as a part of the adjustment. GDP had been falling continuously since 1980.

While useful progress had been made in reducing the financial imbalances under the 1983/84 stand-by arrangement, the attainment of an external position that was viable and consistent with adequate and stable growth clearly would require the ongoing adjustment effort to be maintained over several years, Mr. Finaish remarked. Needless to say, the success of the adjustment effort would also depend on better weather conditions, a more favorable external environment, and the availability of necessary financial support. The authorities would have to maintain sound fiscal and credit policies and implement structural measures to improve the supply side of the economy. The proposed stand-by arrangement for 1985 should help to carry forward the adjustment process that had been initiated, and he supported it.

The proposed reinforcement of budgetary and credit policies under the new stand-by arrangement should make possible a further reduction in the fiscal deficit and in the rate of inflation and the channeling of a larger proportion of credit growth to productive sectors, Mr. Finaish commented. As to public expenditure policy, care should be taken to avoid placing an undue burden of expenditure containment on investment outlays. Given the present and prospective debt servicing position, the policy of continued caution and prudence in foreign borrowing operations was well advised.

The proposed stand-by arrangement included substantive structural and supply-oriented measures, including the liberalization of pricing and marketing policies, further reform efforts aimed at improving the tax system and the performance of public enterprises, and the adoption of a well-defined public investment program, Mr. Finaish continued. In all those areas, more ambitious efforts were envisaged by the authorities as part of a follow-up medium-term recovery program, including the introduction of a value-added tax, a comprehensive reform plan for public enterprises, and the adoption of a three-year public investment program currently being prepared with World Bank assistance as part of a forthcoming structural adjustment loan. The staff should comment further on the proposed value-added tax, including its initial scope in relation to the existing system of indirect taxation. A further comment on the structural adjustment loan, including its proposed timing and the amounts being considered, would also be helpful. With respect to the medium-term investment strategy, an important objective should be the promotion of export diversification to lessen the country's dependence on uranium exports.

On the basis of the proposed adjustment policies and of its assumptions about the external environment, the staff had projected a further significant drop in the external current account deficit during 1985, Mr. Finaish observed. Assuming that the authorities would persevere in implementing adjustment policies, the staff had projected that the payments position would steadily improve, and that a surplus would be recorded in 1988, an encouraging scenario.

Further comments on two aspects of the medium-term balance of payments scenario would be helpful, Mr. Finaish continued. First, the external position to be reached by end-1988 was characterized by the staff as representing achievement of balance of payments viability. While the projected position would undoubtedly represent a considerable improvement over the recent past and a significant movement toward balance of payments viability, he wondered whether it could appropriately be considered as the point of viability itself, as, even then, according to staff projections, Niger would not have completed what could be called the import-compression stage of adjustment. As shown in Table 9, the medium-term scenario assumed virtually no growth in import volume even by 1990; and the volume of imports of capital goods and raw materials in particular would remain substantially below that reached at the start of the 1980s. If imports were permitted to resume their normal growth, the balance of payments picture would be different, ceteris paribus, with a deficit and resource gap possibly still existing at the end of the forecast period.

Second, he wondered whether the large and continuous drop in the volume of imports of capital goods and raw materials since 1981 and the assumed absence of any growth in those imports before 1990 were consistent with the projected annual GDP growth rate of 3 percent over the period 1985-90, Mr. Finaish remarked. If the assumption were to prove to be accurate there would have to be considerable compression of the ratio of imports of such goods to investment and/or GDP with no adverse effect on the GDP growth rate.

Ms. Bulloch said that she agreed with the broad thrust of the staff appraisal. The proposed decision was acceptable. The authorities were to be commended for the performance of the economy under the stand-by arrangement. All the performance criteria had been met, and the moderate reductions in the rate of inflation and in the external current account deficit, despite adverse exogenous developments, were encouraging.

The measures in the proposed stand-by arrangement aimed at reforming the parastatal sector were particularly welcome, Ms. Bullock went on. The close involvement of the World Bank both with the public enterprises and in the formulation of the medium-term investment program was fully appropriate.

The successful completion of the proposed stand-by arrangement would constitute a significant step toward balance of payments viability, but the debt service burden of the public sector would exert pressure on the external accounts for a number of years to come, Ms. Bullock remarked. That fact raised the question of how the Fund could best assist Niger in 1985-86 and beyond. Further Fund support would be required and would be appropriate in parallel with reschedulings by the commercial banks and the Paris Club. At present, the possibility of an extended arrangement for Niger should be approached with caution. Such arrangements naturally depended heavily on there being a reasonable degree of stability in a country's medium-term prospects. Niger's external position was heavily

dependent on uranium exports, which accounted for about three fourths of total exports. A further comment by the staff on the degree of certainty about future revenues from uranium exports would be helpful. Uncertainty about revenues from a dominant export commodity could complicate a member country's adjustment effort. The Niger authorities might wish to consider whether adherence to a medium-term arrangement might not impose substantial strains on the economy that could be avoided through the flexibility provided by a series of shorter arrangements. Her comments were not meant to imply that she doubted the authorities' determination to maintain the adjustment effort.

Mr. Ismael said that the proposed decision was acceptable. The present stand-by arrangement was on track; all the measures under the 1983/84 program had been implemented, and all the performance criteria had been observed. The decline in real GDP in 1984 was due to adverse weather conditions and would have been greater in the absence of the adjustment effort.

He agreed with the staff that the proposed stand-by arrangement would help the authorities to consolidate the progress they had made thus far in restoring a viable medium-term balance of payments position, Mr. Ismael continued. The authorities had taken difficult decisions affecting demand management and the supply side of the economy, including a reorientation of public investment priorities, further reform of public sector enterprises, and changes in pricing and marketing policies. As a result, the adverse effects of the drought and the closure of the border with Nigeria had been considerably moderated.

The improvement in the external current account was encouraging, Mr. Ismael said. In addition, the budget deficit had been sharply reduced, owing mainly to the significant cut in investment expenditure. The problems facing the economy had been exacerbated by the large public investment budget, and the deep cuts under the present adjustment program had been appropriate. The authorities' efforts to liberalize pricing and marketing policies should help to improve resource allocation and encourage both production and exports, and the reform of the public enterprise sector was essential to reducing the sector's financial imbalance, which had made a significant contribution to the budget deficit. The World Bank should be of considerable assistance in helping the authorities to prepare a detailed reform program.

Mr. Dallara stated that the proposed decision was acceptable. Niger's good performance under the present stand-by arrangement and the comprehensive adjustment program for 1985 were evidence of the Government's continuing commitment to restructure the productive sector and reduce the balance of payments disequilibrium.

The authorities had taken a number of commendable steps under the present stand-by arrangement, Mr. Dallara commented. The deregulation of the cereals sector, with the elimination of controls on transport and prices, should have positive effects in the near future. In addition,

the budget deficit on a cash basis had been reduced from 7.3 percent of GDP in 1982/83 to an estimated 6.9 percent in 1983/84. While a shortfall in revenues had occurred because of the drought conditions, the authorities had maintained stringent control of expenditures. Indeed, the growth of current expenditure had barely kept pace with inflation, owing partly to the wage freeze. In addition, the level of investment had been reduced to bring it more in line with the absorptive capacity of the economy, and approximately half of the investment had been channeled to the directly productive sectors. The close cooperation between the authorities and the World Bank on the overall investment strategy was welcome, and he hoped that the remaining differences of view could be quickly eliminated, thereby paving the way for a comprehensive approach to investment.

The substantial reduction in domestic arrears had exceeded the program target, Mr. Dallara noted. It should help to restore the fiscal health of the Government's domestic suppliers, including the parastatals.

As to the proposed program, Mr. Dallara said, the emphasis on encouraging further increases in efficiency and productivity was welcome. The authorities planned to continue the ongoing effort to dismantle several state monopolies. In that connection, the necessary studies of the parastatal sector had been completed, and the implementation of the recommended reforms had been started. He attached particular importance to progress in that area and looked forward to examining it during the next review, by which time the planned liquidation or privatization of selected parastatals should be accomplished.

The fiscal measures in the new program should sustain the adjustment effort, Mr. Dallara considered. The tax reform seemed sound and should distribute the tax burden equitably, but he hoped that the industrial and commercial profits tax would not be so high as to discourage private sector production and investment; during the 1984 Article IV consultation with Niger, the staff had reported that the rate was 50 percent. The policy of limiting overall expenditure growth to 2 percent was appropriate. The authorities intended not to propose a general wage increase for the third consecutive year, a difficult objective in the circumstances of Niger.

Monetary policy under the new program seemed appropriate, Mr. Dallara commented. The expansion of total credit was to be limited to 11.1 percent, 6.6 percentage points of which would be allocated to the nongovernment sector, compared with a decline in both 1983 and 1984. He hoped that as private sector activity increased, credit to the Government could be more restrained, thereby permitting the reallocation of credit to the private sector to continue, if necessary.

The various measures in the 1985 program, together with the expected exogenous developments, should further reduce the external current account deficit, to 2.8 percent of GDP, Mr. Dallara considered. In addition, the external arrears were to be eliminated, and no new nonconcessional debt was to be acquired. Given the current and prospective debt situation, the emphasis on concessional aid was fully consistent with the medium-term

prospects for the economy, in general, and the external debt position in particular. Table 8 summarized the rather tenuous medium-term position of the economy and the further costs inevitably associated with the present rescheduling. While the balance of payments was projected to be in equilibrium by 1989, debt service payments would still be absorbing 26 percent of total current account earnings. Hence, the authorities would have to maintain a prudent debt strategy after the 1985 program to avoid facing even higher debt service ratios than at present. In that connection, he looked forward to the answers to Mr. Finaish's questions on the medium-term prospects for the economy.

While he agreed with previous speakers that the Fund would have to continue to support Niger's adjustment efforts, it was premature to determine the most appropriate form of continued Fund support, Mr. Dallara said. A cautious approach was warranted, and the performance of the economy in the coming period should be carefully observed.

The continuation of Niger's adjustment effort despite adverse weather conditions and soft export markets was welcome, Mr. Dallara remarked. The proposed program emphasized policies to stimulate real production and growth as well as fiscal responsibility. Therefore, it seemed appropriately balanced and should provide the basis for continued adjustment to restore growth and a sustainable balance of payments.

Mr. Salehkhou noted that the proposed stand-by arrangement was equivalent to only 47.5 percent of Niger's quota. Niger's economy had made considerable progress during the 1970s owing to the world demand for uranium; in that period, there had been rapid expansion of both current and capital expenditures, and heavy borrowing had been required to finance the investment program.

During the 1980s, world demand for uranium had fallen, causing a deterioration in Niger's terms of trade, Mr. Salehkhou continued. In addition, weather conditions had become unfavorable, foreign aid had declined, the public enterprises had experienced financial difficulties, and, by end-1983, Niger's external public debt service had reached the equivalent of 19 percent of exports and 43 percent of budgetary revenues. The adjustment program for 1983/84, prepared in cooperation with the Fund and the World Bank, had dealt primarily with the imbalances inherited from the early 1980s. Under the 1983/84 program, the authorities had cut public expenditure, increased tax collections, reduced domestic government arrears, improved the financial position of the public enterprises, decelerated domestic credit expansion, restrained foreign borrowing, and met all the performance criteria. However, the drought, the closure of the border with Nigeria, and the reduction in investment had caused a further drop in real GDP of 3.8 percent, rather than the expected increase of 0.4 percent. The agricultural sector had performed poorly because of the drought, and the mining sector had remained stagnant owing to the continued weak demand for uranium.

To consolidate the progress in 1984 and to achieve a sustainable rate of economic growth, the Government intended to continue its adjustment effort throughout 1985, Mr. Salehkhou observed. The new program called for a rate of GDP growth of 3 percent, a rate of inflation of no more than 6.5 percent, and a reduction of the external current account deficit, including grants, from 3.9 percent of GDP to 2.8 percent. Taking into account external debt service payments and drawings on committed loans, the overall balance of payments deficit was estimated to amount to SDR 39.2 million; it was to be financed by purchases from the Fund under the proposed stand-by arrangement and by external debt rescheduling.

To achieve the program objectives, the authorities intended to liberalize the marketing and pricing of cereals, reinforce the financial position of public enterprises, and adopt a moderate investment program, Mr. Salehkhou continued. At the same time, they would attempt to reduce the budget deficit to 4 percent of GDP through tax measures and by limiting the increase in expenditures to 2 percent. The authorities had also adopted a tight credit policy and would maintain prudent external debt management. The new measures were expected to help reduce the external current account deficit from SDR 60 million--3.7 percent of GDP--in 1984 to SDR 48.2 million--2.8 percent of GDP--in 1985. The external accounts and official reserves were expected to improve in 1985, owing mainly to firmer uranium prices, more favorable weather conditions, and a reduction in imports. However, the balance of payments deficit was expected to remain at SDR 39 million and was to be financed partly by rescheduling of public debt under the Paris Club at a meeting scheduled for November 30, 1984. The staff projections were based on a 5 percent increase in uranium prices, and he hoped that that assumption would prove correct. A World Bank mission had just completed a thorough review of the Government's development strategy and medium-term investment program and had concluded that the composition and level of the budget were generally appropriate and were in line with the Government's commitments. Another World Bank mission--in October 1984--had reviewed the Government's program for public enterprises and had concluded that the authorities were committed to reforming the public enterprise sector by privatizing a number of the enterprises and by creating a special unit to supervise the sector. The Government's program for the sector was to be supported by structural adjustment credit from IDA.

The authorities were aware of the importance of continuing the adjustment effort, Mr. Salehkhou remarked. They seemed committed to making every effort to observe the performance criteria in 1985, as they had in 1984. For those reasons, and given the positive outlook for the balance of payments, the staff appraisal seemed appropriate, and he warmly supported the proposed decision.

Mr. Abdallah said that he broadly agreed with the staff appraisal. The proposed decision was acceptable. The authorities were to be commended for adhering to the 1984 program, despite the severe drought and the closure of the border with Nigeria. The close collaboration between the authorities and the World Bank was welcome. Although the planned volume

of investment seemed rather large, the authorities felt that it was realistic, and he hoped that the donor community would provide the necessary financial support. The authorities clearly recognized the need to diversify production away from the present heavy dependence on uranium.

The authorities' efforts to reform the parastatal enterprises were welcome, Mr. Abdallah remarked. Such organizations in Niger and other African countries had tended to accumulate substantial losses and had become a major drain on public finances. Firm action was needed to reduce their losses and to improve their operational efficiency.

Mr. Ortiz said that he welcomed the authorities' efforts to continue adjusting the economy to the external shocks, including the fall in the price of uranium and the severe drought.

The medium-term balance of payments projections were based on the assumption that the price of uranium--the main export--would increase, Mr. Ortiz noted. The staff had projected a 5.1 percent increase in the value of Niger's exports in 1985, but no growth in export volume was expected. He wondered whether the assumption was warranted, particularly in the light of the expected 14 percent decline in uranium prices in 1984 as a result of the severe cuts in energy-related nuclear programs in many countries. The import projection for Niger presumably was based on the availability of foreign exchange should the export estimates prove to be correct. He doubted whether the moderate overall increase in imports expected in 1985--less than 1 percent--would permit GDP to grow at the projected rate of about 3 percent, particularly as the projected import growth was limited to consumer goods, while intermediate and capital goods imports were expected to decline further in 1985 even in nominal terms; a considerable decline in real terms was expected. In sum, he wondered whether the main program objectives, namely, a reduction in the rate of inflation and an increase in GDP, were consistent with the import projections. Finally, Niger's request for a new stand-by arrangement was acceptable.

The staff representative from the African Department remarked that the fiscal deficit on a commitments basis had been reduced from 7.3 percent of GDP in 1982/83 to 4.7 percent in 1983/84, despite a drop of 3.5 percent in revenues owing mainly to the closure of the border with Nigeria--which had adversely affected customs revenues--and the decline in economic activity in Niger. New tax measures had limited the fall in revenues by contributing the equivalent of some 0.6 percent of GDP in additional receipts in 1983/84. On the expenditure side, the authorities had reacted to the drop in revenues by reducing expenditures more rapidly--16 percent--than had been originally planned. Public investment had been cut sharply--by 46 percent--and the growth in current expenditure had been limited to 8 percent, mainly through economies in administrative expenditures, a wage freeze, and strengthening of expenditure controls.

The budget deficit on a cash basis was expected to be reduced from 6.9 percent of GDP in 1983/84 to 4.3 percent in 1984/85, and the arrears were to be eliminated, the staff representative continued. The increase in total expenditures was to be limited to 2 percent in 1984/85; to that end, the growth of the wage bill would be held to only 5 percent, as there would be no cost of living adjustment, and new hiring would be restricted. Transfers to public enterprises, which had been substantially reduced in 1983/84, would be held at the same level in 1984/85, while expenditure control would be further strengthened; and investment expenditure would be held at the 1983/84 level. On the revenue side, growth was to reach 6.6 percent owing to measures implemented in 1983/84 and new measures planned for 1984/85, including the registration of property for tax purposes, computerization of taxpayers for personal income tax purposes, and the introduction of a simplified system for the assessment and collection of the industrial and commercial profits tax. The value-added tax had not yet been introduced, pending the training of personnel who could administer it. No problems had arisen in administering the 50 percent industrial and commercial profits tax, but there were a number of deductions and exemptions that reduced its effective level; for instance, new factories were exempt for five years, and capital gains were exempted if reinvested.

As to credit policy in 1985, the staff representative said that there had been virtually no growth in credit to the private sector in 1984 and the emphasis in 1985 was to be shifted toward the nongovernment sector in order to support a resurgence of economic activity. The increase in credit to the government sector was to be much more moderate in 1985 than in 1984.

Significant progress had been made in 1983/84 in two ways: by reforming five key enterprises through reductions in staff and stocks and by modifying pricing policy--including increasing tariffs and adopting a more flexible attitude toward markups--the staff representative continued. The reduction in government arrears to the public enterprises had significantly improved the financial position of a number of enterprises, and the authorities had made progress in preparing to rehabilitate the Development Bank and the Agricultural Credit Agency. Under the program for 1984/85, preparations would be made, in consultation with the World Bank, for a comprehensive reform of the overall public enterprise sector. A World Bank mission to Niger in October 1984 had made considerable progress in defining a timetable and measures for the reform of the public enterprises and in identifying 23 enterprises that presented the alternatives of being turned over to the private sector, made into joint ventures, or liquidated. Furthermore, reflecting the Government's commitment to reform, a new Ministry in Charge of Public Enterprises had been established in September 1984. Pending the completion of the preparations for launching the comprehensive reform of the public enterprise sector, the authorities would continue in 1984/85 with their reform of five key enterprises--namely, the State Grains Cereals Agency, the National Irrigation Office, the Development Bank, the Agency for Underground Water Supply, and the Post and Telecommunications Agency.

The considerable reduction in the level of investment in 1983/84 had resulted in a higher implementation ratio than in previous years--80 percent--as the investment target had been more closely in line with the country's administrative capabilities and absorptive capacity, the staff representative remarked. In addition, there had been a greater emphasis on productive projects, with investment in the production sector accounting for 46 percent of total investment. The level of investment in 1984/85 was to be about the same as in 1983/84. The process of selection of exports and the total amount of investment for 1984/85 had been carefully examined by a World Bank mission, whose members had agreed with the authorities that both the planned level and composition of the public investment program for 1984/85 were appropriate and were in line with the Government's policy objectives. Sixty percent of total investment in 1984/85 was to be directed toward the production sector, and 26 percent would be devoted to rural development. The World Bank was providing assistance in the formulation of the 1986-88 investment program as part of the preparations for a structural adjustment loan for Niger. The World Bank mission in October 1984 had made considerable progress, and further discussions were to be held in the near future. The Fund staff had worked closely with the World Bank during the previous year, exchanging views in order to coordinate assistance in formulating the adjustment strategy.

The objective of the pricing and marketing policies was to diversify and increase the incentives for production, the staff representative noted. Under the proposed program, imports and inter-regional trade in cereals would be liberalized. To that end, retail prices would be brought into line with market-oriented prices. A system of tenders and bids for wholesale purchases and sales--administered by the state Grain Marketing Agency--had already been instituted, and the first tender for the sale of cereals by the agency had been made in October 1984. The liberalization of exports of cowpeas, which was the monopoly of a state agency, was expected to improve production by increasing incentives both to producers and traders; henceforth, they would be able to export directly, without the involvement of the state agency.

The staff fully shared the concern expressed by Executive Directors about the external debt, the staff representative commented. The debt service ratio for 1985 was expected to reach 38 percent, and it was for that reason that the authorities were expected to refrain from contracting any new nonconcessional loans during the program period and to seek debt rescheduling by the Paris Club and commercial banks for the second time.

The staff projection that a viable balance of payments position would be reached by 1988, the staff representative said, was based on a number of assumptions: the adjustment effort would be continued; an appropriate public investment program would be implemented; there would be a moderate improvement in the international environment; no further deterioration in the terms of trade would occur; weather conditions would not be unduly unfavorable; and the border with Nigeria would continue to be closed. The medium-term prospects would improve if the border were reopened. There was of course uncertainty about the price of uranium in the coming period.

The staff's projection reflected the latest information about the prospects for the uranium market. The price of Niger's uranium exports was based on negotiations between Niger and the main importer of uranium from Niger.

The staff had projected no real growth in imports in the medium term, the staff representative remarked. The program included a number of structural reforms to increase production and improve resource allocation as well as to encourage import substitution in particular. Further, a basic assumption of the medium-term scenario was that the adjustment efforts to contain domestic demand would be maintained.

As to the relationship between imports and economic growth, the staff representative from the African Department indicated, much depended on the nature of the public investment program. Many of the projects implemented in the past had been import intensive and had involved long gestation periods. Achieving a specified rate of economic growth in the future would not necessarily require a higher level of imports; it was the improvement in the allocation of investment resources that was essential. The authorities' close cooperation with the World Bank in the effort to establish an appropriate public investment program should result in a considerable improvement in resource allocation that could contribute to a higher rate of economic growth even in the absence of an increase in the level of investment.

Mr. Alfidja observed that the authorities fully understood the importance of diversifying production, particularly in agriculture. While the production of cowpeas had been undermined by the closure of the border with Nigeria, the main market for that crop, the authorities hoped to make progress in diversifying production; to that end, the liberalization of the marketing system should make a significant contribution.

There was some uncertainty about the future price of uranium exported by Niger, Mr. Alfidja commented. The price, negotiated between Niger and the major importers of uranium, was usually well above the market price. More would be known about the price at the time of the next staff mission to Niger, probably in March 1985.

The authorities were determined to reform the public enterprise sector, Mr. Alfidja said. In Niger, as in other countries in a similar situation, it was often difficult to find a private entity willing to purchase and operate a public enterprise. The latest World Bank mission had included a person whose main responsibility was to contact private parties to ascertain their interest in acquiring certain public enterprises.

Mr. Finaish remarked that the staff response to his questions on the balance of payments projections, the assumption about imports, and the consistency of that assumption with the projected GDP growth rate were unconvincing. For instance, while some import substitution might occur, there was a limit to the extent of import substitution that could be

realized over just a few years; besides, finding domestic substitutes for imported raw materials and capital goods might be difficult, if at all possible. He would pursue the matter with the staff on a bilateral basis.

The Executive Board then took the following decision:

1. The Government of the Republic of Niger has requested a stand-by arrangement for the period from December 5, 1984 to December 4, 1985, in an amount equivalent to SDR 16 million.

2. The Fund approves the stand-by arrangement set forth in EBS/84/221, Supplement 1 (11/28/84).

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7848-(84/169), adopted
November 26, 1984

4. THE GAMBIA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with The Gambia (SM/84/239, 10/25/84). They also had before them a report on recent economic developments in The Gambia (SM/84/254, 11/13/84).

The staff representative from the African Department said that since the circulation of SM/84/239, a staff mission had visited The Gambia to conduct the first review under the stand-by arrangement. The staff and the authorities had agreed on performance criteria for the balance of the program period and on additional adjustment policies to be implemented in 1984/85. The corresponding letter of intent was under review by the staff. In addition, a donors' conference, in which a staff member would participate, was scheduled to be held in Banjul on November 28-30, 1984.

Mr. Abdallah made the following statement:

The vulnerability of the Gambian economy to adverse weather conditions was once again highlighted in 1983/84. The recurrence of drought during that period led to a decline of 51 percent in the production of food grains, while the production of groundnuts, the main source of The Gambia's foreign exchange and the raw material for the manufacturing sector, dropped by more than 26 percent. Consequently, it is estimated that real GDP stagnated in 1983/84, having increased at an average rate of more than 12 percent in the preceding two years. Directors will recall that inadequate rainfall in The Gambia in 1979/80 and 1980/81 resulted in a similar problem when total output of groundnuts dropped from 167.4 thousand metric tons in 1978/79 to 68 thousand metric tons in 1979/80 and 60.2 thousand metric tons in 1980/81.

Poor weather conditions, however, have not been the only constraint on the Gambian economy. There have also been wide fluctuations in the export price of groundnuts--the sharp increase in groundnut production in 1982/83 was not reflected in increased export receipts because of a large drop in export prices--and efforts to increase domestic value added in the agricultural sector have encountered difficulties due to restrictions on exports of processed groundnuts in the European market. Under the circumstances, it is clear that factors beyond the control of the authorities play a major role in determining developments in the Gambian economy and on many occasions have weakened the impact of domestic policies. Thus, the authorities have experienced problems in meeting not only short-term targets in the context of their adjustment program but also with regard to the longer-term goal of economic diversification.

Economic policies in The Gambia in the past few years have been consistent with the goals of balanced economic growth, financial stability, and a viable balance of payments position in the medium term. In connection with a Fund-supported program, the dalasi was devalued by 25 percent in February 1984. Steps have also been taken to contain the growth in expenditure, and interest rates have been raised. The authorities were able to meet most of the prescribed criteria, except those relating to credit and external arrears. This was due to unforeseen developments beyond the control of the authorities, such as delays in processing and transporting the groundnut crop, and a higher import bill, mainly on account of food imports made necessary by the drought.

Performance criteria aside--although important as a gauge on the extent to which adjustment is taking place--several indicators suggest that progress is being made toward improving the economic situation in The Gambia. The fiscal deficit declined from the equivalent of 20.1 percent of GDP in 1981/82 to 13.6 percent in 1983/84, while bank financing of the deficit declined from 7.5 percent to 5.5 percent in the same period. As for the money supply, the rate of increase slowed to 7.4 percent in 1983/84, compared with an increase of 35 percent in the previous year. Some improvement can also be seen in the external sector, as indicated by the trend in the current account deficit, which has declined by about 10 percentage points relative to GDP compared with the situation in 1981/82.

The Gambian authorities intend to build upon the progress that has been made indicated by the direction of policy in the current fiscal year. Bearing in mind the need to strengthen the real sector of the economy, the authorities are making efforts to further the objective of diversification within the context of the Second Five-Year Development Plan. A decision has been

taken to revise and extend the plan to cover the period up to 1987/88. A preliminary conference on the revised plan took place last May, to be followed by a donors' conference in November 1984. One of the plan's projects to be implemented in 1984/85 is a $30 million agricultural project, aimed at improving farm incomes through the introduction of better inputs and extension services. Meanwhile, the authorities intend to keep producer prices at remunerative levels; accordingly, they have increased the price for cotton and rice by 20 percent and 10 percent, respectively.

In the fiscal area, additional steps have been taken to increase revenue, while efforts are being made to restrain expenditure. In this regard, there will be no supplementary appropriations in 1984/85 without equivalent savings elsewhere in the budget. Therefore, it is expected that the budget deficit will decline further, from the equivalent of 13.6 percent of GDP in 1983/84 to 10 percent of GDP in 1984/85. Borrowing from the banking system is projected to fall from 4.1 percent of GDP to 1.6 percent during the same period.

The measures that have been adopted with a view to improving the performance of public corporations are an integral part of the overall strategy that is geared to strengthen the financial position of the public sector. The monitoring role of the National Investment Board has been expanded, and efforts are underway to improve the price structure of a number of public corporations.

Monetary and credit policies continue to reflect the Government's concern about inflation and the need to reduce pressure on The Gambia's balance of payments. Steps are being taken, however, to satisfy the credit needs of the productive sectors.

The current account of The Gambia's balance of payments improved in 1983/84, but the authorities are aware that the external payments situation remains difficult. They are concerned about the low level of external reserves and the debt service burden. It is the intention of the authorities, therefore, to exercise care with respect to short-term external borrowing. One of the major problems in the external sector in recent years has been the large drop in both official and private capital inflows. This is particularly worrisome because the Gambian economy is not likely to generate the level of domestic resources needed to expand its development program. The devaluation of the dalasi in February 1984 has helped to improve the competitiveness of The Gambia in tourism and exports of livestock. However, as far as the medium-term prospects are concerned, much will depend on the groundnut sector, including price changes in the international market and prevailing weather conditions. The balance of payments will, in all likelihood, move to a surplus position by 1987/88.

Mr. Robinson indicated that he endorsed the staff appraisal. The Gambia's economic situation continued to be extremely difficult, despite the authorities' substantial efforts in recent years. The external conditions had been unfavorable, and large fiscal and external imbalances remained; the external debt was still large, and the external arrears had continued to increase, reaching the equivalent of nearly 80 percent of merchandise exports.

In the circumstances, while the authorities' inability to meet most of the end-June 1984 performance criteria was disappointing, he agreed with Mr. Abdallah that that had happened mainly because of factors beyond the authorities' control, Mr. Robinson continued. He was pleased that negotiations to bring the program back on track seemed nearly completed and that the country had eliminated some of its arrears to the Fund. Nevertheless, the combination of volatile export receipts, low reserves, and a heavy burden of debt service--of which 40 percent over the coming two years would be due to the Fund--continued to be a cause for concern. As experience during the previous six months had shown, developments that seemed at first glance to be of relatively little importance, such as shipment delays, could cause a further buildup of arrears, including arrears to the Fund. Until reserves could be increased, daily foreign exchange management would continue to be very difficult.

Although the authorities had taken steps to improve expenditure control, freeze recruitment in the civil service, and increase revenue, the fiscal deficit, excluding grants, had been larger than anticipated, owing partly to the continuing difficulties of the parastatals, Mr. Robinson remarked. The authorities' efforts through the National Investment Board to improve the situation were welcome, and the likely surplus--the first in five years--of the Gambian Produce and Marketing Board was encouraging. However, much remained to be done by the Marketing Board and the other parastatals, particularly the Gambian Utilities Corporation, whose operating deficits had placed substantial pressure on the budget. He wondered whether the U.N. consultant's report on the parastatals had been completed, and what progress had been made in phasing out the fertilizer subsidy, a major cause of the difficulties facing the Marketing Board.

He welcomed the authorities' intention to reduce the fiscal deficit to 10 percent of GDP in 1984/85 and to make public savings positive for the first time since 1979/80, Mr. Robinson said. However, to reduce the deficit by the targeted amount, the authorities would have to increase revenues by 23 percent; a further comment on the feasibility of that objective would be useful. At the same time, they would have to control current expenditure, which had grown twice as fast as GDP since 1978/79. It was important to stress the need to plan development expenditure in the light of the budget and balance of payments constraints, and of the available administrative and managerial capacity.

A more detailed discussion of the appropriateness of the exchange rate policy, and particularly of the peg to the pound sterling, would have been helpful, Mr. Robinson remarked. He hoped that a more extensive presentation would be included in future staff reports on The Gambia. While short-term capital outflows had fallen considerably over the previous year, they were still significant and were projected to increase in 1984/85. Given the critical balance of payments constraint and the need to begin to make significant progress in reducing arrears, the short-term capital flow should be reversed; to that end, some increase in interest rates might be helpful.

The continuing inadequacies of The Gambia's statistical reporting were a cause for concern; they undoubtedly increased the difficulty in policymaking, Mr. Robinson commented. He wondered whether there was not scope for further technical assistance by the Fund and the World Bank.

Mr. Goos remarked that recent economic developments in The Gambia had been mixed. Some of the improvements--for instance, in the external current account--during 1982/83 had been sustained and even strengthened in 1983/84, while the position of the Central Government had continued to deteriorate. On balance, economic developments had been less than satisfactory in 1983/84, particularly when actual results were compared with original program estimates. The external position continued to be very difficult: reserves were low; external arrears had increased; and the debt service ratio was high. The staff's medium-term scenario suggested that the recent improvements in the external current account would not be sustainable if present policies were maintained.

In the circumstances, decisive and comprehensive adjustment efforts were of crucial importance, Mr. Goos continued. The efforts would certainly be difficult, given the stagnation in real incomes, but the staff analysis clearly showed that there was considerable scope for further action. That the authorities agreed with the staff analysis was encouraging. They had already adopted a number of important measures that were in the right direction. For instance, they had shown renewed resolve to contain the public sector deficit and had decided to authorize supplementary appropriations only if they were accompanied by corresponding savings elsewhere in the budget. Their efforts to improve the public enterprises were welcome, but they should give additional consideration to the extent to which certain public services could be provided more efficiently by private enterprises. In addition, the increased emphasis on market-oriented pricing and exchange rate policies was welcome and should be increased to provide appropriate incentives to domestic production; the new emphasis could play an important role in the crucial effort to diversify the export base away from the strong dependence on groundnut exports.

The staff appraisal could have usefully placed more stress on interest rate policy, Mr. Goos considered. Interest rates had recently been increased by 2 percentage points, but they were still negative in real terms. Positive real interest rates would help to reduce the rate of inflation, stem the large short-term capital outflow, and improve the

allocation of resources. The authorities might also wish to reconsider the appropriateness of applying quantitative credit guidelines to each commercial bank.

The Gambia's overdue financial obligations to the Fund were a cause for serious concern, Mr. Goos said. The Fund's considerable exposure in The Gambia was reflected in the growing share of the debt service ratio that was due to Fund credit. There was also an urgent need to improve the country's statistical base and its reporting of data to the Fund.

The lack of any discussion in the staff report on the ongoing integration of Senegal and The Gambia was surprising, Mr. Goos commented. An analysis of the effects of that effort on The Gambia's economy would have been helpful.

Ms. Lundsager remarked that The Gambia, like many other African countries, had suffered from poor weather conditions and had had to increase its food imports. In addition, transportation of export crops had been disrupted by the need to transport rice imports. Despite the recent increases in producer and other prices, the introduction of various budgetary measures, and a significant adjustment of the exchange rate, the most recent performance criteria had not been met. However, the delays in receiving expected foreign exchange were likely to be short, and The Gambia might well be able to meet the next set of performance criteria. In that connection, the recent additional increases in producer prices before the start of the new planting season were welcome, and the authorities should be urged to eliminate the new subsidy on rice as soon as possible. She was pleased that petroleum products were no longer subsidized. Additional price liberalization might eliminate the financial difficulties of the parastatals.

The external policies had been somewhat successful, Ms. Lundsager considered. The devaluation in February 1984 had increased the competitiveness of the tourism and livestock sectors, but the lack of further adjustment in the nominal rate since then had already eroded some of the real effect of the devaluation. The authorities should be encouraged to adjust the exchange rate as frequently as necessary to maintain the competitiveness of the traded goods sector. Although the external current account deficit had been significantly reduced, it was still excessively large--more than 23 percent of GDP.

The medium-term outlook for the economy was a cause for concern, Ms. Lundsager said. A financing gap had emerged for 1984/85, assuming no further purchases from the Fund, and it was projected to be almost four times as large in 1985/86. Financing the gaps by accumulating additional arrears would merely increase the cost and disrupt the regularity of imports. The arrears to the Fund were still a serious problem, although additional donor assistance might be feasible and nominal increases in such assistance had been built into the balance of payments table in the staff report. Emphasis must be placed on broadening the structural

reforms, particularly pricing policy--including the exchange rate--to expand the production of traded goods and services, thereby reducing the projected current account deficit. Finally, the proposed decision was acceptable.

Mr. Ainley considered that the staff report clearly showed that The Gambia continued to face serious economic and financial problems that were deep-rooted and likely to persist for some time. Even on the most favorable assumptions, the immediate prospects were not encouraging, despite the authorities' commendable efforts to deal with the problems. Their firm commitment to adjustment had been amply demonstrated by the comprehensive measures introduced under the stand-by arrangment. Their failure to observe some of the end-1984 performance criteria had been due mainly to adverse external developments beyond their control.

The authorities had no alternative but to continue the adjustment effort in the coming period, Mr. Ainley commented. First priority should be given to bringing the Fund-supported program back on course and, in that connection, the latest information provided by the staff was encouraging. The present program provided the right framework for correcting the imbalances in the economy. Fund support was essential if The Gambia were to encourage other donors and creditors to assist in its adjustment efforts. The policies outlined by the authorities for 1985 were in the right direction. The continued emphasis on restructuring the economy and diversifying the productive base was particularly welcome. The authorities had already had some success in reviving tourism, and the recent adjustments in producer prices should help to stimulate production of the main export crops. The World Bank's support of the authorities' efforts to improve productivity in the all-important groundnut sector was encouraging.

In the short run, fiscal restraint would be vital, and the new revenue measures in the 1984/85 budget, together with the proposed improvements in the system of expenditure control, were therefore welcome, Mr. Ainley continued. Several of the parastatal enterprises continued to face serious financial problems, and he hoped that the authorities would press ahead with their plans to reorganize them and to introduce more flexible pricing polices.

On the monetary side, Mr. Ainley said, the authorities' intention to maintain their restrictive credit policy and the initiatives they had taken to finance a larger part of the budget deficit by nonmonetary means were welcome and should be continued. He was pleased that the World Bank was closely involved in the effort to strengthen the financial sector.

Despite the improvement in export earnings, the balance of payments was likely to remain under pressure in the coming period, Mr. Ainley commented. Still, the authorities should give priority to phasing out the arrears as soon as possible, particularly in view of the importance of attracting foreign assistance. In that context, the recent settlement of some of the overdue obligations to the Fund was encouraging. The Fund

could play a useful role in catalyzing new financial flows to The Gambia; therefore, it was crucial that the country remain current in its obligations.

The authorities were moving in the right direction, but they had little room for maneuver, Mr. Ainley concluded. Their adjustment efforts could be successful only if they were supported by the international financial community. Hence, he hoped that the Fund-supported program could be revived quickly and that the outcome of the coming donors' conference would be positive.

Mr. Chatah remarked that after impressive growth of more than 12 percent in the two years through end-1983, real GDP in The Gambia was estimated to have stagnated in 1984, owing mainly to the effects of the drought on agricultural production. Given the heavy reliance on rain-fed agriculture and the overdependence on groundnuts for foreign exchange earnings, the close relationship among overall economic performance, weather conditions, and developments in the world market for groundnuts was inevitable. Efforts to increase production and to diversify exports must be strengthened, and the pricing policies under the program--particularly adjustments in producer prices of agricultural products--were therefore particularly welcome. He was pleased that despite the adverse recent developments, the authorities had continued to maintain their longer-term pricing policy objectives.

It was regrettable that having failed to meet the end-June 1984 performance criteria, The Gambia had not been permitted to make a second drawing under the present stand-by arrangement, Mr. Chatah continued. However, that outcome was not surprising, given the adverse effects of the drought on fiscal and monetary policy implementation; and there were reasons to feel somewhat optimistic about the outlook for the economy in the coming period: the basic policies under the present program had been implemented, and the authorities were clearly committed to making needed adjustments within the framework of the present stand-by arrangement. In particular, producer prices for groundnuts, cotton, and rice had been increased; the announcement of the increases ahead of the planting season should have provided the proper incentives to farmers in a timely fashion.

The fiscal position was expected to improve as a result of both an increase in revenue from the higher import duties on petroleum products and certain luxury items, and the decision not to authorize supplementary appropriations without making equivalent savings elsewhere in the budget, Mr. Chatah went on. However, the performance of parastatals continued to be a cause for concern, and he hoped that the relevant ongoing studies would result in concrete action to improve their financial situation.

The improvement in the balance of payments during the previous year had been encouraging, Mr. Chatah said. However, the external position would clearly remain under pressure for some time, particularly in view of the low level of external reserves and the relatively high debt service

ratio. The authorities' commitment to external adjustment was reflected in the substantial devaluation of February 1984. Their cautious approach to short-term external borrowing was commendable.

The staff had forecast a decline to about 6 percent per year over the coming five years in the rate of growth of revenue from tourism, Mr. Chatah noted. In addition, however, the staff had suggested that the tourist sector itself should expand in the coming period due to increased use of facilities during the off-peak season. A further comment on that explanation would be helpful. He wondered whether it either implied a shortage of existing facilities or was meant to suggest that an expansion of those facilities would not be feasible because of the concentration of use in the peak season.

The authorities had clearly indicated their commitment to adjustment, despite the unforeseen problems, particularly the severe drought, and he hoped that the Fund-supported program could be brought back on track, Mr. Chatah concluded. The Gambia must become current in its obligations to the Fund, and any additional information on that subject would be helpful.

Mr. Hodgson said that the renewed commitment to sound economic management reflected in the present stand-by arrangement was encouraging. The authorities had made progress in a number of areas--for instance, in the economic pricing of such goods as petroleum products, rice, and groundnuts. However, the severe drought and difficult market conditions for groundnuts had limited economic growth, hampered the expansion of exports, and greatly complicated the task of economic management. The likely wide fluctuations in export earnings in the coming period underscored the importance of maintaining a strong and consistent approach to economic management.

He agreed with the staff that the authorities should be urged to implement fully the stand-by arrangement, Mr. Hodgson remarked. Their failure to meet all the end-June 1984 performance criteria was regrettable. They had faced serious problems because of the drought and tight market conditions, but it was unfortunate that they had been unable to make additional efforts to meet all the performance criteria, thereby enabling them to make the remaining purchase under the stand-by arrangement. Finally, the proposed decision was acceptable.

The staff represantative from the African Department remarked that the arrears to the Fund of SDR 683,984 mentioned on page 1 of the staff report had been eliminated. However, additional arrears of about SDR 421,000 subsequently had been accumulated. The staff intended to discuss the matter with the authorities in the immediate future.

The report by the U.N. expert on parastatals had been completed, but the authorities felt that it was excessively descriptive and had themselves undertaken additional studies, the staff representative explained. Meanwhile, the staff and the authorities had agreed on a

number of measures affecting parastatals; they would be described in detail in the report for the review under the stand-by arrangement. The staff intended to encourage the authorities to take further action in the areas covered by the studies. As to the reduction of fertilizer subsidies in particular, the authorities had adhered to the schedule supported by the World Bank and the Fund.

During its visit to Banjul in October 1984, the staff had been reasonably satisfied that the 1984/85 budget was on track, the staff representative said. However, the parameters within which budgetary policy was implemented could change quickly. The budgetary situation was fragile, and the staff was monitoring it closely.

The authorities were fully aware of the desirability of transferring parastatal enterprises to the private sector, the staff representative commented. Some privatization--particularly of hotels--had occurred in the tourist sector.

The integration of Senegal and The Gambia was a political matter and was still being discussed by the authorities of the two countries, the staff representative explained. The staff had carefully taken a neutral position in order to avoid prejudicing the outcome.

Given the difficulties in the external economy, the depreciation of the real effective exchange rate by 15 percent in January-June 1984 was appropriate, the staff representative said. The staff was examining the appropriateness of the peg to the pound sterling in the light of the broader issue of the need for increased flexibility in the design of Fund-supported programs.

Deposit interest rates were already positive in real terms, the staff representative noted. Moreover, the ceilings on lending rates had been removed under the previous Fund-supported program, and the authorities were prepared to take another look at the rates on savings. Given the 2 percentage point increase in interest rates on savings in 1983/84, the rate of inflation, and the prospects for 1984/85, the staff had concluded that no further interest rate action was required for the time being.

The projected increase in tourist receipts was moderate for two reasons, the staff representative said. First, the sector's receipts had already increased rapidly in 1982-84, following the disturbances in 1981, and the sector was unlikely to perform as strongly in the immediate future. Second, the substantial increase in tourist facilities following the disturbances was unlikely to be repeated in the coming period. The Fund and World Bank staffs had encouraged the authorities to consolidate the expansion achieved in recent years and to pay close attention to the need to maintain confidence in the tourist sector--a sector of crucial importance to the economy.

The Fund had provided technical assistance in the external debt area, and substantial progress had been made in determining the stock of debt and the level of external arrears, the staff representative from the African Department said. The relevant data were still not fully reliable, but the data base was on a much firmer footing. The Central Banking Department continued to provide technical assistance to the Central Bank. The Fund had also provided technical assistance in the fiscal area during the previous several years. The staff anticipated that the authorities would continue to benefit from technical assistance in the coming period.

Mr. Abdallah considered that the staff's forecast of tourist receipts was conservative. Such receipts tended to fluctuate greatly over time, but the 6 percent rise forecast by the staff seemed on the low side.

Studies undertaken by outside experts on the parastatal enterprises tended to be excessively theoretical in nature, and the authorities' decision to commission additional studies using local expertise available in The Gambia was unsurprising, Mr. Abdallah said.

The authorities were making every effort to reach an understanding with the Fund on appropriate policies for the coming period, Mr. Abdallah remarked. The Gambia and other African countries appreciated that understandings with the Fund and the World Bank enabled them to receive the external resources required to solve the problems facing their economies. At the same time, it was important for the international community to appreciate the various problems facing the smaller sub-Saharan countries, where a difficulty that seemed relatively minor--such as a delayed shipment--could have serious adverse consequences, perhaps even preventing the authorities concerned from observing performance criteria.

The Chairman made the following summing up:

> Directors expressed broad agreement with the views contained in the staff appraisal for the 1984 Article IV consultation with The Gambia. They considered that the adjustment measures taken by the authorities in the context of the Fund-supported program in early 1984 had contributed to avoiding a further widening of the internal and external imbalances in the economy. However, Directors regretted that, partly because of unforeseen developments outside the control of the authorities, as well as some slippages in policy implementation, The Gambia did not meet the fiscal and external sector targets for fiscal 1983/84 and the performance criteria for end-June 1984.
>
> Directors, referring to the difficult short- and medium-term outlook and the severe foreign exchange constraint, underscored the importance of continued determination by the authorities in implementing and persevering with strong adjustment policies. In this context, they welcomed the additional adjustment measures being taken within the framework of the program for fiscal 1984/85, and emphasized that the authorities should stand ready, if

necessary, to take additional measures to ensure that the program with the Fund will be brought back on track. Directors stressed the need for tighter budgetary and credit policies, continued wage restraint, realistic pricing policies, and measures to improve the financial performance of parastatal entities, as well as measures to restructure the productive base and encourage private sector activity, tourism, and exports, and to avoid private capital outflows.

Directors were concerned that external arrears had increased substantially in the last fiscal year, a development that should be reversed as soon as possible. Directors urged the authorities to eliminate their arrears to the Fund promptly and to avoid any re-emergence of such arrears in the future. They also indicated their concern with regard to the very large debt burden of The Gambia and stressed that export diversification should be accorded a high priority. Directors urged the authorities to maintain a flexible exchange rate policy to maintain the competitiveness of the traded goods sector.

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

The Executive Board then took the following decision:

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

2. The Gambia's exchange system contains restrictions on payments and transfers for current international transactions, involving external payments arrears, and a multiple currency practice, as described in SM/84/254, which are subject to approval under Article VIII. The Fund urges the authorities to remove these restrictions as soon as possible.

Decision No. 7849-(84/169), adopted
November 26, 1984

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/168 (11/21/84) and EBM/84/169 (11/26/84).

5. NEPAL - TECHNICAL ASSISTANCE

In response to a request by Nepal Rastra Bank for technical assistance, the Executive Board approves the proposal set forth in EBD/84/289 (11/15/84).

Adopted November 21, 1984

6. AUDIT COMMITTEE, FY 1985 - COMPOSITION

The Executive Board approves the proposal to invite Bangladesh, Greece, and the United States each to nominate a member of the External Audit Committee for the financial year 1985 as set forth in EBAP/84/248 (11/20/84).

Adopted November 26, 1984

7. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 84/80 are approved. (EBD/84/290, 11/16/84)

Adopted November 23, 1984

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and an Advisor to Executive Director as set forth in EBAP/84/247 (11/20/84) and by an Assistant to Executive Director as set forth in EBAP/84/219, Supplement 1 (11/20/84) is approved.

9. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/84/252 (11/23/84) is approved.

APPROVED: August 21, 1985

JOSEPH W. LANG, JR.
Acting Secretary