NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/64

10:00 a.m., April 20, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
	C. Taylor
J. de Groote	
	A. Le Lorier
	J. Delgadillo, Temporary
R. D. Erb	C. Dallara
	T. Alhaimus
	Jaafar A.
	T. Yamashita
	G. W. K. Pickering, Temporary
	C. Robalino
G. Laske	
	L. Barbone, Temporary
	V. K. S. Nair, Temporary
	S. El-Khouri, Temporary
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	J. A. K. Munthali, Temporary
	M. Toro, Temporary
	A. Lindå
	Jiang H., Temporary

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

Administration Department: J. D. Huddleston. African Department: O. B. Makalou, Deputy Director; E. L. Bornemann, S. E. Cronquist, A. B. Diao, B. R. H. S. Rajcoomar, M. Sidibé. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Kanesa-Thasan, P. A. Molajoni. External Relations Department: N. K. Humphreys, Chief Editor. Legal Department: Ph. Lachman, J. V. Surr. Research Department: C. F. Schwartz, Associate Director and Director of Adjustment Studies; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. Artus, J. M. Boughton, D. J. Goldsbrough, M. D. Knight, A. Lanyi, A. K. McGuirk. Secretary's Department: A. P. Bhagwat. Treasurer's Department: A. G. Chandavarkar, G. Wittich. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. E. Conrado. Assistants to Executive Directors: H. Arias, R. Bernardo, J. Bulloch, L. E. J. Coene, T. A. Connors, G. Ercel, C. Flamant, I. Fridriksson, W. Moerke, Y. Okubo, J. K. Orleans-Lindsay, J. Reddy, J. Schuijer, Wang C. Y., J. C. Williams.

1. RWANDA - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with Rwanda (SM/83/31, 2/8/83; and Sup. 1, 4/6/83). They also had before them a report on recent economic developments in Rwanda (SM/83/53, 3/17/83).

Mr. Alfidja made the following statement:

The vigorous signs of growth that characterized the economy of Rwanda during 1977-81, when an annual average real growth rate of 5 per cent was recorded, changed slightly in 1982 with an annual real growth of 4 per cent. At the same time, the relative financial stability that prevailed during the implementation of the Second Development Plan (1977-81) showed some deterioration. This largely reflected unfavorable external developments, namely, a worsening in the terms of trade of Rwanda's principal exports and a substantial decline in capital inflows.

In 1982, adverse weather conditions slowed down the output of coffee, the main export crop and an important source of budget revenue. In the manufacturing and the construction sectors, output stagnated. This, combined with a slowdown in the growth of export crop receipts, contributed to a weakening of Rwanda's overall financial position.

Government revenue, which had increased by 11 per cent in 1981 compared with an annual average increase of 20 per cent during 1977-80, reached only 9 per cent in 1982, in spite of the efforts of the authorities to improve customs duty collection and an upward revision in import tariffs. From a surplus position in 1980, Rwanda's budget thus shifted to a deficit both in 1981 and 1982, estimated at 1.9 per cent of GDP.

The financing of the budget combined with the need to provide credit for financing coffee stocks, and for easing the financial difficulties of the mining sector, resulted in a large and rather exceptional credit expansion in 1982. Against this background, however, the authorities succeeded in reducing the rate of increase in broad money from 12.5 per cent in 1981 to 9 per cent in 1982. The inflation rate increased slightly from 7 per cent in 1981 to about 10 per cent in 1982, reflecting increases in the tariff rates for energy and water and in tuition fees.

In 1982, Rwanda incurred an overall balance of payments deficit of SDR 37.9 million. This was due to the continued deterioration in the terms of trade as mentioned above and a continued increase in the cost of petroleum products.

The authorities are aware that the economy will continue to face adverse external developments in 1983, especially for its principal export commodities--coffee, tea, and tin. In the light of these uncertainties, they have had to introduce on a temporary basis an advance import deposit scheme, which took effect on March 1, 1983. The objective of this measure is to reduce the relatively high level of luxury imports and thereby alleviate the pressures on the balance of payments.

As far as the medium-term prospects are concerned, the authorities are determined to implement sound investment policies in the context of the third five-year development plan (1982-86). The annual growth rate under the plan is, therefore, set at 4.8 per cent compared with 6 per cent under the second plan, and below the actual growth rate of 5 per cent recorded in previous years. Under the plan, the principal aim is to ensure self-sufficiency in food production and widen the economic base through export diversification and an expansion of the manufacturing sector, including agricultural processing industries. The development of manpower resources is also an important objective. For the attainment of all these objectives, the authorities have placed emphasis on raising productivity, improving absorptive capacity, and implementing projects of a productive and employment-generating nature. Furthermore, agricultural policy will continue to be geared toward more regionalization and the improvement of internal transportation and agricultural marketing. In keeping with their prudent external borrowing policies, the authorities intend to mobilize larger domestic resources for the new development plan. Budgetary policies will thus be formulated to reduce further growth in current as well as in investment expenditures. To this end, Fund technical assistance has been requested to review budgetary procedures, expenditure control, and government accounting. The authorities have also requested the Fund to assist them in conducting a survey aimed at reviewing the tax structure and its administration to ensure that the tax system is more responsive to the needs of the economy. Currently a Fund staff mission is visiting Kigali. The burden of public enterprises on the budget is also of great concern to the authorities. In order to prevent these enterprises from exerting further pressures on the budget, the authorities have asked for technical assistance from the World Bank.

In 1983, the authorities will continue to pursue strong demand management policies to restrain pressures on domestic prices and the balance of payments. In this connection, they have increased several consumption taxes. In support of fiscal policies the authorities will keep monetary developments under close review and ensure that the gains made in controlling the inflationary rate will not be eroded. A better coordination of budgetary and monetary policies will be established and in particular the existing instruments for credit control will be put to active use.

Finally, an area of concern to my Rwandese authorities is the need to find a satisfactory relationship between their currency and those of Rwanda's major trading partners. My authorities have asked me to express their deep appreciation to the Fund for its assistance in this field. The contacts with the staff and the study of the Rwandese exchange system carried out by the latter have been very helpful. The appropriate policy recommendations will be implemented as soon as the authorities have completed the review of the effects of these recommendations on the country's medium- and long-term development objectives.

Mr. de Groote noted that the situation in Rwanda had changed significantly during the preceding two years. Earlier, as shown by all previous consultations with the Fund, Rwanda's performance had been an example of success. Despite the well-known constraints--landlocked situation, high population density, limited natural resources, and transportation difficulties--Rwanda had, nevertheless, maintained an enviable record. Income had expanded at a relatively high rate per capita; the budget had generally been in balance, sometimes in surplus; and local resources had accordingly been made available for investment in infrastructure. The inflation rate had been the lowest in Africa, and the management of debt had remained more prudent than in any other country under comparable conditions.

With the benefits of such exceptional achievements in the areas under its control, Mr. de Groote continued, the Rwandese Government had been able to continue to obtain over the years important amounts of concessional assistance from traditionally friendly countries, in particular, Belgium, France, the Federal Republic of Germany, Japan, and the United States. In 1979, official transfers and official long-term capital in Rwanda had represented the equivalent of 92 per cent of imports. In other words, as a result of those long-term flows, the country had been able to import almost twice what it could have normally imported.

Rwanda's favorable situation had, however, changed radically about two years earlier, Mr. de Groote observed, under the combined influence of extremely unfavorable international prices for Rwanda's exports and a strong appreciation of its currency. Rwanda could not have done much about the foreign exchange losses induced by the unfavorable evolution of prices for its exports. As a small supplier, the country faced competitively set prices for its exports of minerals, coffee, and tea. The quantity of coffee the country could export was subject to internationally fixed quotas. Given the capacity constraints on its production of minerals, it had not been possible to increase production to recoup Rwanda's foreign exchange losses incurred because of the decrease in its foreign currency export prices.

The problem created by the unfavorable changes in foreign exchange receipts had been compounded by a strong appreciation of the domestic currency, Mr. de Groote stated. Since the end of 1980, the nominal

effective exchange rate of the franc had appreciated by about 25 per cent. In real terms, the appreciation amounted to about 20 per cent, a change that had had a far-reaching effect on public finances and on resource allocation; it lay at the heart of Rwanda's current imbalances.

For Rwanda, as for all developing countries under the present conditions of low commodity prices and declining world trade, Mr. de Groote went on, the whole question of adjustment came down to the choice of appropriate policies for limiting the effect of such unfavorable conditions on incomes and development. It could be argued that Rwanda had systematically followed opposite policies from those advocated by the Fund since the beginning of the present crisis and explicitly recommended for Rwanda at the conclusion of the previous Article IV consultation in August 1981 (EBM/81/115). The pronounced revaluation of the exchange rate, reflected in sharply declining import prices in local currency terms, had had pronounced immediate effects on consumption. The share of consumption in GDP had increased by 2 percentage points between 1981 and 1982, and the increase in 1983 could be expected to be even larger. The savings ratio had declined markedly; the resource gap, as measured by the current account deficit, had widened by more than 1 per cent of GDP in 1981 and, according to recent information, by 2 per cent in 1982. Imports, partly financed through multilateral concessional assistance, had successfully competed against domestic production, discouraging import substitution. Export diversification had also suffered a setback as a result of exchange rate appreciation: small and medium-sized firms oriented toward the markets of neighboring countries had found it increasingly difficult to penetrate them.

Public finance had been dramatically affected by the exchange rate situation, Mr. de Groote added. The greater part of fiscal proceeds came from an ad valorem export tax on coffee, tea, and minerals; fiscal receipts from coffee exports had fallen in a two-year period to about one fourth of their previous level. While the Coffee Stabilization Fund had continued to pay the same nominal price to producers, the coffee exports that had previously been the source of the budget surplus had had to be massively subsidized. The mining company had only been able to survive as a result of exceptional assistance from the banks. The impact of the situation on the monetary aggregates and on the price level was evident. The budget deficit, which had to be financed through money creation, had already shown a significant increase in 1982 and, according to more recent indications, the deficit would more than double in both 1982 and 1983, reaching about 6 per cent of GDP in 1983. The favorable effects on the price level expected from the revaluation of the Rwandese franc had been more than offset by the monetary expansion resulting from the need to subsidize exports. As a result of such developments, Rwanda's good relations with traditionally friendly countries had been greatly eroded. The non-implementation of the Fund's recommendations on the occasion of the previous Article IV consultations had had an unfavorable effect in Belgium, where assistance to developing countries was geared to their compliance with Fund policies.

The situation deserved special attention, Mr. de Groote remarked, because it contained two paradoxical aspects. First, Rwanda's excellent record in the past could have enabled it to adjust more effectively than many other countries by a single decision to peg the currency to a more appropriate peg than the U.S. dollar, such as the SDR or another basket of currencies. If that decision had been taken a year and a half earlier, Rwanda's situation would have been much better than that of almost any other country with a comparable income level. The debt position of Rwanda would have facilitated the adjustment. At present, foreign debt represented about 15 per cent of GDP, while debt service represented no more than 6 per cent of export value. The total debt had a maturity of 35 years, with 9 years of grace, and an average interest rate of less than 1 per cent. If a decision to offset the appreciation of the exchange rate was taken soon, there was still a good chance to reverse the unfavorable trends that had developed following revaluation, because the country had had such a remarkable record in the past.

The other paradoxical aspect of Rwanda's present situation, Mr. de Groote emphasized, was that the country could easily qualify for financial assistance from the Fund if it complied with the Board's recommendations on exchange rate policy. Such assistance would be especially welcome at a time when Rwanda was starting to implement its five-year development plan. It was a matter of great concern to all Rwanda's friends that such an important potential contribution to the country's economic future was being held up by an exchange rate situation inherited from the past, a situation that had become an anomaly. Official transfers and official long-term capital had remained at a high level in Rwanda during the preceding three years, although their importance in relation to imports had declined as a result of the marked increase in imports. He was convinced that those capital flows, essential for Rwanda's development, would be maintained and that they would very likely be increased, if Rwanda complied with Fund recommendations.

Some econometric studies had clearly shown the consequences of an adjustment of the rate by an amount that would offset the effect of the appreciation, i.e., by about 25 per cent, Mr. de Groote went on. It was appropriate to use that figure since there was no reason to envisage a devaluation from the exchange rate prevailing two years earlier in a country that was otherwise well managed. An adjustment of 25 per cent at the end of 1982 would have resulted in a public sector surplus in 1983, in contrast to the deficit of RF 2.6 billion in 1982 and RF 5 billion in 1983 in the absence of a corrective rate adjustment. On the same basis, the improvement in public finances would continue until 1986, with a cumulative surplus of RF 5 billion for 1983-86, instead of a projected deficit of RF 16 billion under present exchange rate policies. Those budgetary surpluses would allow for a yearly increase in public investment of about RF 1.25 billion during the same period, alone accounting for an increase of 0.5 per cent in GDP. The deficit in the balance of payments would diminish by 25 per cent in the year after the adjustment and by 15 per cent in the following year. Internal prices would increase, as a result of such a decision, by about 10 per cent at most during the year

after the adjustment, and by about 12 per cent in the following year; after three years, the adjustment would, however, lead to price decreases as a result of improved supply and reduced monetary financing. In sum, the price increases that would accompany the adjustment would amount only to half of the increases that otherwise would take place as a consequence of expanded monetary financing of the government deficit and of subsidies to producers. From the beginning of 1985 to the end of 1987 consumer price increases could be estimated to be 27 per cent in the absence of an adjustment, and 12 per cent with an adjustment at the end of 1982 of the size described.

Undue importance should not be attached to the calculations, Mr. de Groote commented. They were not necessarily precise, however, they were indicative of probable trends; the calculations clearly indicated that everything was to be gained from a realistic exchange rate determination, in Rwanda as in other countries.

Recently, Rwanda had instituted an advance import deposit requirement scheme, in order to contain imports of luxury goods, Mr. de Groote observed. Those measures did not conform to the Fund's policies and they were bound to introduce further misallocations of resources. Nevertheless, Directors might have to accept them, in the expectation that comprehensive measures would be taken in the future. Similar measures might have to be envisaged for some categories of exports, such as coffee and minerals, pending a more fundamental decision. The precise meaning of such a decision had to be kept constantly in mind in the Board's discussions of the exchange rate in Rwanda and in the dealings of the staff with the Rwandese authorities. The point was to offset the effects of the revaluation resulting from the peg to the U.S. dollar, not to devalue. Even the word devaluation should be avoided in order to dispel misunderstandings on that point.

Mr. Polak commented that Mr. de Groote had indicated the two fundamental considerations that had to be borne in mind when considering Rwanda's economy: the handicap of a landlocked country with a number of great difficulties, including a high population density, and almost 4 per cent growth in population annually. On the other hand, the country's good record until a year or two earlier, its prudent financial policies, its liberal trade policies, and its small debt service had to be considered. Such factors implied that Rwanda was in a relatively favorable position to deal with the problems that had been emerging in the previous two years, problems that were partly due to the low prices for its exports, about which it could do little, and partly due to an overvalued currency, predominantly arising from Rwanda's decision to peg its currency to the U.S. dollar.

The staff recommended, as it had done in 1982, that Rwanda should depreciate its currency more or less to the extent necessary to compensate for the unintended appreciation as the currency had risen in conjunction with the dollar, Mr. Polak continued. The staff also recommended that thereafter the currency should be pegged to the SDR. The advice was correct, but he could understand why the authorities had found it difficult

to follow it hitherto, and he welcomed Mr. Alfidja's remarks indicating that the authorities were close to coming to a conclusion on the advice that they had received from the staff.

Devaluation was normally the advice given to countries with a poor record, Mr. Polak remarked, countries that had pursued inadequate policies leading to large budget deficits or high inflation rates. Rwanda was not among those countries. The inflation rate had been relatively low until 1982, when it had been less than 10 per cent. The budget deficit was less than 2 per cent of GNP. A country in that situation might well hesitate before it took action associated with more profligate countries forced to devalue their currencies. In fact, Rwanda would not have had to take any exchange rate action, if it had managed to keep its currency stable in terms of the average of the currencies of its major trading partners. It had suffered from the accident of pegging to the U.S. dollar; as a result, there had been a substantial real appreciation of the currency, and an increase in real wages, which probably could not be afforded.

It was necessary for the country to correct promptly and in the least traumatic way possible that accident of history, Mr. Polak suggested. A shift to an SDR peg could be a useful cover for that operation. The essential point was not the shift to the SDR, but a shift to a lower value in terms of other currencies. If the country did not take such a step soon, it would continue to face the difficulties that it had been facing in recent years. There was a close connection between the budget situation and the appreciation of the currency, because the support for coffee exports and the reduction in the coffee export tax both greatly affected the budget. The Stabilization Fund from which those funds had been paid could well be running out of money. The present policy also impaired the achievement of export diversification and self-sufficiency in food, which were aims of the third development plan. Although coffee had declined in value, exports of noncoffee items had declined as a percentage of total exports, and imports had been made unduly cheap. No major import-substituting industry had been created in the previous year. In light of such difficulties, the country was resorting to highly undesirable measures, such as the advance import deposit requirement scheme, that were incompatible with its admirable record of liberal trade policy and that could only intensify distortions; there had also been a relaxation of its previously restrained demand management policy. For all those reasons, he urged the Rwandese authorities to make the necessary adjustment as soon as possible.

Prudent fiscal policy would be crucial to the implementation of the next development plan, Mr. Polak observed, which would require domestic as well as external resources. Given the high dependence of Rwanda on capital imports from official sources, it was striking that there had apparently been no World Bank loans to the country. There appeared to be ample opportunity and need for assistance from the World Bank, possibly in connection with an extended arrangement with the Fund and the resumption of the financial relations between the Fund and Rwanda. He strongly recommended that Rwanda, whose basic policies remained in good order, should

enter into close consultation with both the Fund and the Bank for a serious discussion of its economic policies, with the aim of becoming able to draw on the resources of those institutions in order to develop the economy further.

Mr. Munthali commented that the performance of Rwanda's economy had been remarkable in recent years, registering an average rate of growth of real output of 5 per cent between 1977 and 1981, i.e., only 1 percentage point lower than the target set out in the second development plan. Although growth had declined somewhat in 1982, it remained satisfactory by current standards. The authorities should be commended for maintaining the momentum of growth at a time when many developing countries in a similar situation, particularly those in Africa, had been experiencing declines in output.

There had been unsettling developments, however, in the previous two years with respect to the budget and the balance of payments, Mr. Munthali continued. The Government's financial position had weakened in 1981 when the budget had slipped into deficit, after registering successive surpluses in the preceding few years. The balance of payments had also recorded a deficit in 1981, widening significantly in 1982. Although the situation was not serious at present--the fiscal deficit in 1982 had been less than 2 per cent of GDP, and international reserves had remained at a relatively comfortable level--he believed that the authorities would be well advised to begin to take the necessary corrective action to prevent greater problems from developing in the future.

The weakening of the Government's financial position stemmed from the rapid rise in outlays at a time of declining growth in revenue, Mr. Munthali noted, reflecting, in part, the drop in receipts from coffee exports. He endorsed the efforts being made by the authorities to find ways of raising additional revenue, as evidenced by the tax study to be undertaken with the assistance of the Fund. He welcomed Mr. Alfidja's indication that a mission for that purpose was already in Kigali. In the meantime, the authorities would need to continue to exercise restraint over the rate of growth of current expenditure. The information presented in Chart 4 of SM/83/31 was encouraging as it indicated that expenditure could be expected to slow down.

Credit developments in 1981 and 1982 had reflected fiscal expansion, Mr. Munthali observed, as well as increased demand for credit by the private sector as a result of the need to replace coffee stocks and to meet the requirements of the mining company, whose financial position had weakened during the period. He welcomed the authorities' intention to review monetary developments more closely in order to enable them to take appropriate action whenever necessary.

Commenting on exchange rate policy, Mr. Munthali asked whether, in the study that the Fund had undertaken on behalf of the authorities, consideration had been given to pegging the Rwanda franc to a currency basket other than the SDR. If so, what were the benefits of the SDR peg

over other currency baskets? The staff indicated that in the previous plan, mobilization of external resources was being hampered by the apparent weakness in project identification, preparation, and execution. Could the staff or Mr. Alfidja provide information on what specific measures the authorities might be taking to strengthen the Government's machinery to improve project implementation? Finally, what did the staff mean when it described the smelter plant as oversized? Did it mean oversized in relation to the export market or to import substitution?

Miss Le Lorier stated that the absence of a realistic exchange rate was the problem most likely to impair the performance of Rwanda. The case was well described in the staff papers, and it was all the more worrisome because Rwanda had been for a number of years an excellent example of sound financial and economic management, achieving impressive results with regard to high rates of growth, budget surpluses, the very low level of external debt and debt service, and substantial official reserves. Those commendable achievements were threatened by the emergence during the previous two years of an involuntary revaluation of the exchange rate, as a result of the overappreciation of the U.S. dollar to which the local currency happened to be pegged.

To date, the authorities had been concerned by the short-run inconveniences that would arise from correcting what Mr. Polak had appropriately referred to as an "accident of history," Miss Le Lorier continued, notably the potential inflationary effects of such a correction. Rwanda's performance with regard to inflation had been quite satisfactory; a devaluation would certainly, at least temporarily, worsen the situation. Moreover, the overvaluation of the Rwanda franc did not affect, at least in the short run, the value of exports, since Rwanda was a price taker on international markets. However, the situation had adverse consequences, which the authorities themselves had acknowledged. In particular, the overappreciation had encouraged a remarkable increase in import volume. The authorities had recently taken a decision to introduce new exchange arrangements to try to curtail the rate of growth of imports, but the advance import deposit requirement scheme was a much less efficient measure than action to correct the currency peg system. It combined the disadvantage of a devaluation, in terms of higher prices for imported goods, with the long-term drawbacks of a continuing overvaluation for the export sector. Furthermore, the scheme could eventually bring about an unwanted rise in domestic credit, and it could have adverse effects on real economic growth if it were to create shortages of imports, such as raw materials and agricultural goods. She hoped, therefore, that the authorities would adopt in the near future a new exchange rate policy to allow for a more realistic rate.

Such a decision would have a number of immediate advantages, Miss Le Lorier commented. Inter alia, it would allow a substantial increase in prices, particularly for coffee, the relative price of which had worsened dangerously over the previous five years. It would also help to restore the financial position of the mining company and, therefore, to ease its borrowing requirements, which were responsible for the rapid increase in

domestic credit over the previous two years. Furthermore, it would help to improve budget receipts by increasing import duties. Finally, she supported the remarks of other Directors in favor of active technical assistance from the Fund to Rwanda.

Mr. Dallara said that he supported the proposed decision. The authorities had succeeded in maintaining a relatively rapid rate of growth during the previous two years in the prevailing external circumstances. For a number of years, Rwanda had had a generally impressive record of economic management that had contributed to its ability to attain steady real growth. For most of that period, growth had been accomplished within the framework of budget and balance of payments sustainability. The authorities deserved Directors' admiration for such accomplishments.

However, a number of troubling developments had emerged in the preceding two years, Mr. Dallara continued, including a marked deterioration in both the fiscal and external areas. Recent developments in fiscal policy were a matter of concern. The Rwandese authorities had requested Fund assistance both to review budget procedures, expenditure control, and government accounting, and to survey the tax system. He invited the staff to comment on the status of those two requests. At present, pending more detailed information on the results of those studies, he endorsed the conclusions and recommendations in the staff appraisal with regard to domestic financial policies, in particular the emphasis on the need to mobilize additional domestic resources. He welcomed Mr. Alfidja's comments on that area. According to the information presented in Appendix II of SM/83/31, gross capital formation appeared to have risen slightly as a percentage of total expenditure in recent years, from about 13 per cent in 1978 to 14 per cent in 1982. However, Table 1 in SM/83/53 indicated that consumption exceeded 90 per cent of GDP. He invited the staff to provide information on how those data compared to similar data in other countries in the region, and on the implications of the Rwandese data for future policies. He also invited the staff or Mr. Alfidja to comment further on the final 1983 budget.

With regard to the medium-term outlook, Mr. Dallara considered that the provision in the staff report of a medium-term framework within which to evaluate Rwanda's economic prospects and policies was particularly useful. It was clear that the period up to 1985 would be challenging, but, as his chair had noted on previous occasions, Rwanda was in a relatively favorable condition to weather the difficulties, in light of the foresighted buildup of surpluses in the past, if the authorities took appropriate measures. He urged the authorities to pursue the mix of prudent and disciplined economic policies that they had shown themselves capable of implementing fully in the past. He agreed with the staff that it was appropriate to place priority on the development of agriculture in the 1982-86 development plan. He supported the emphasis on raising productivity and improving absorptive capacity, points to which both the staff and Mr. Alfidja had referred. Prevailing producer prices for export commodities might no longer be sufficiently remunerative; for example, the real

producer price for coffee had declined by almost 40 per cent since 1977. He noted the staff's observation that pricing policies for tea, pyrethrum, and quinine bark also appeared to have had an adverse effect on output and exports. It was important that appropriate producer pricing policies be pursued, in order to provide the best opportunity for export growth and diversification.

Since an appropriate exchange rate was necessary to maintain a realistic producer price structure, Mr. Dallara remarked, it was clear, with the benefit of hindsight, that pegging the Rwanda franc to the U.S. dollar had not been the most effective strategy during the recent past. The result indicated that a shift in policy, possibly to a basket of currencies such as the SDR, was needed, and it also indicated a need to adjust the rate. He encouraged the authorities to examine the situation carefully with a view to adopting policies at an early stage broadly consistent with their development objectives and the achievement of a sustainable external position. In Rwanda's case, depreciation should not be seen as an indication of policy failure, but as an affirmative step fully consistent with Rwanda's demonstrated capacity to deal effectively with economic problems. In that connection, he hoped that the changes in the Rwandese exchange system that had become effective on March 1, 1983 could be eliminated in the near future; he welcomed Mr. Alfidja's comments to the effect that the changes were temporary.

The staff representative from the African Department noted that one Director had commented on the lack of World Bank loans to Rwanda. While it was true that the World Bank per se had not made any loans to Rwanda, Rwanda had been eligible only for IDA loans. Since 1970, Rwanda had in fact received 18 IDA credits, totaling $188 million. In addition, the World Bank was providing technical assistance to help the Rwandese authorities to formulate their investment program. The Bank was also providing assistance in the area of project implementation, and the staff hoped that the rate of implementation of projects would increase significantly in the coming years. Fund technical assistance in the fiscal area consisted of a tax survey mission and counsel regarding expenditure control. The first mission was at present in Kigali; with regard to the second mission, the Fiscal Affairs Department had already put before the Rwandese authorities the name of an expert for their consideration and the staff was awaiting their reply.

The staff's preference for pegging the Rwanda franc to the SDR had been based on the results of a simulation exercise that it had undertaken, the staff representative continued. The exercise had suggested that a peg to the SDR would have resulted in less fluctuation in the nominal exchange rate. The study had evaluated the effects of other baskets, including one suggested by the National Bank of Rwanda.

Rwanda's smelter plant had a capacity of 4,500 tons a year, the staff representative noted, well above Rwanda's current maximum production of 2,100 tons. The staff had judged therefore that the plant was oversized in relation to production. Although the authorities had an investment

program aimed at expanding production, the staff did not expect that it would have a significant impact before 1985. In the meantime, production costs would remain relatively high.

The latest information available on the 1983 budget indicated that the authorities foresaw a deficit of RF 1.8 billion, the staff representative observed, generally in line with the information provided by the staff in SM/83/31. The authorities had introduced additional revenue measures that were expected to result in a 21 per cent increase in revenue to RF 19.5 billion, but, unfortunately, expenditure would also rise rapidly, mainly as the result of capital expenditures. As Directors were aware, capital expenditures in Rwanda consisted largely of counterpart funds. A more worrisome development was that net lending to parastatals was projected to increase rapidly in 1983, mainly as the result of loans to the Coffee and Tea Stabilization Funds as well as to the sugar factory. Those developments did not change the staff's overall appraisal.

Consumption had been rising steadily in Rwanda, the staff representative from the African Department remarked. Wages policy had been relatively lax; in 1978, wages had been raised in the public sector and in 1980, they had been increased again substantially in both the public and private sectors. It was a pattern common to the region--in a number of countries total consumption, and particularly public consumption, had been rising rapidly.

Mr. Alfidja commented that Rwanda's case was difficult; the past record was good, yet, as a number of Directors had suggested, the country might find itself in an increasingly difficult situation if corrective measures were not taken in the near future. One particular problem was the scarcity of skilled personnel, especially in the countryside. The authorities had attempted to reform the educational system so as to encourage people to remain in the countryside, a policy that had necessitated significant expenditures. They had initially sought assistance in that field from friendly countries, but they had considered the problem sufficiently important to use their own resources in the meantime. The shift in the educational pattern was one reason for the recent increase in public expenditure.

If Rwanda took the appropriate corrective measures, Mr. Alfidja continued, perhaps external assistance, both bilateral and multilateral, would increase sharply. However, it should be borne in mind that the decline in assistance to poor countries such as Rwanda had been brought about by more complex factors than the adoption of a particular policy, e.g., an appropriate exchange rate.

His Rwandese authorities would welcome Directors' recognition of their past good record, Mr. Alfidja commented, and they would regard the Board's comments as an appropriate example of the Fund's surveillance role, which applied to all countries alike. However, Directors should bear in mind that public opinion played an influential role in Rwanda, and that it was sensitive to the consequences of the policies undertaken

by the authorities, with regard to their impact both nationally and on neighboring countries. Therefore, the authorities had wished to proceed cautiously in changing the currency peg. However, they would soon reach a definitive position. It would be unwise to comment on whether the authorities would take the opportunity to correct the appreciation against the U.S. dollar, because of the danger of any such comments giving rise to speculative activity. The authorities were convinced that it was in their own interest to follow much of the Fund's advice. They might not implement every recommendation, but they would move in the right direction.

The Chairman made the following summing up:

Directors agreed with the thrust of the views expressed in the staff appraisal in the report on the 1982 Article IV consultation with Rwanda. They noted that over the previous two years Rwanda's economy had continued to expand at a relatively rapid pace, but that, in contrast to the past, when rapid growth had taken place in an environment of admirable internal stability, since 1980 growth had been accompanied by a marked weakening of the overall financial situation. That latter development reflected not only the considerable deterioration in Rwanda's terms of trade and the decline in net inflows of official transfers and capital, but also an undue relaxation of demand management and an inadequate exchange rate policy. The Rwanda franc had been allowed to appreciate significantly in real terms as a result of the fixed peg to the U.S. dollar, a development that, in turn, had had a marked adverse impact on the balance of payments. It had contributed to a very sharp rise in consumption and imports, had discouraged domestic savings, and had compounded the budgetary difficulties.

Directors welcomed the fact that the new development plan continued to accord priority to the development of agriculture, notably food production, to the expansion of the manufacturing sector, and to export diversification. Consequently, and in view of the need to raise larger domestic resources for the financing of investment, and given the uncertainties regarding external conditions, Directors stressed the vital role of supportive pricing, incomes, and demand management policies.

More specifically, Directors stressed the adverse impact of the appreciation of the Rwanda franc in real effective terms in the previous two years. Directors emphasized the importance of an urgent reversal of the recent appreciation in order to strengthen the competitive position, the financial situation, and, more generally, to achieve the medium-term objectives of the plan. They stressed that those objectives would be better served by a general exchange rate action than by restrictive measures designed specifically to curb imports. In that connection, Directors urged the authorities to review the pegging of the Rwandese currency to the U.S. dollar. A different peg, such as, for example, to

the SDR, could be more appropriate in the circumstances. Directors were encouraged to hear that the authorities were giving urgent attention to that issue and that they intended to take appropriate action in the exchange rate field. At the same time, Directors emphasized the need for the speedy elimination of the import deposit requirement.

Directors also underscored the need for fiscal restraint and prudent monetary policy. The rapid growth of current expenditures should be contained and additional domestic resources should be mobilized. They welcomed the authorities' intention to review the tax system as well as budgetary procedures and controls with the objective of improving fiscal performance. The importance of Fund technical assistance in the budgetary areas was emphasized. They also stressed the importance of eliminating the operating deficits of the public enterprises, a policy that would assist in generating domestic savings.

A number of Directors expressed the hope that further collaboration between Rwanda and the Fund could result in a financial arrangement.

It is expected that the next consultation with Rwanda will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

Decision Concluding 1982 Article XIV Consultation:

1. The Fund takes this decision relating to Rwanda's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Rwanda, in the light of the 1982 Article IV consultation with Rwanda conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Rwanda has introduced an advance import deposit requirement scheme which gives rise to multiple currency practices, as described in EBS/83/66. The Fund encourages the authorities to eliminate the multiple currency practices and the restriction on transfers of earned income of foreigners as described in SM/83/31.

Decision No. 7384-(83/64), adopted
April 20, 1983

2. ANNUAL REPORT, 1983 - OUTLINE AND PROCEDURES

The Executive Directors considered a paper outlining the contents of the 1983 Annual Report and procedures (EBD/83/112, 4/15/83; and Cor. 1, 4/15/83).

Mr. Prowse commented that the Annual Report was a valuable document, in terms of both its actual content and its use as a reference. It afforded the Executive Board an opportunity to present a historical account of its activities during the year, while providing a perhaps unique opportunity to strengthen the Fund's surveillance function through discussion and analysis of the major issues for international consideration and cooperation in areas relevant to the Fund's work. In that regard, it was possible that Directors could use the Annual Report to go further in the direction of policy prescription.

The appropriate balance for the Annual Report was a sensitive issue, Mr. Prowse continued, and over the years, there had been a shift of emphasis in its structure and balance. In the early 1960s the Report had stressed the activities of the Fund in Part I; it had covered international liquidity in Part II; and, in Part III, developments during the year had been reviewed in a fairly narrow focus. The outline suggested in EBD/83/112 was in keeping with the format of recent years, in which more space had been devoted to comments and discussion. In the 1983 Annual Report, Directors could go further in the direction of stating the Board's views on the important matters affecting the global economy, in light of the growing recognition of interdependence and of the need for closer international cooperation. Using the Report in that way would make a positive contribution to surveillance. It would enable the Fund to seek wider support for harmony and convergence in the economic policies of members.

The removal of supplementary notes was a departure from the format of earlier Reports, Mr. Prowse noted. Many of the notes had dealt with issues of considerable importance. For example, as long ago as 1964, the Annual Report had contained a supplementary note on incomes policy, and similar substantial policy issues had been dealt with in other Reports. While it might not be necessary to go back to the format of supplementary notes, the Annual Report should be an opportunity for emphasizing important issues.

In particular, Mr. Prowse suggested, the 1983 Annual Report could deal with the problem of protectionism. Current trends in that area were imposing many burdens on exporters, especially primary producers, with an accompanying distortion of prices and comparative advantage. Directors could state in the Annual Report the comprehensive and solid rationale behind the liberal payments regime that the Fund so consistently advocated. In the 1982 Annual Report, there had apparently been only three, low-key references to protectionism.

A second issue that ought to be stressed, Mr. Prowse continued, was external debt. It certainly warranted a great deal more attention than it had had in past Annual Reports. Perhaps the staff already intended to cover

it in the proposed Chapter 1, in the section dealing with members' endeavors "to restore satisfactory and sustainable rates of economic growth, including in many cases a need to deal with severe problems of external adjustment and financing." On the other hand, it could be covered in Chapter 2 in the discussion of the international monetary system.

A further issue requiring urgent consideration, Mr. Prowse said, was the prospective evolution of the international monetary system. The staff proposed that part of Chapter 2 should focus on the relationship between exchange rate developments and financial policies. Perhaps that section could contain a discussion of foreign exchange market intervention, an issue that would be gaining increased attention in coming months. The arguments could be clarified and the Fund's position could be put forward. He looked forward to consideration of those issues at the drafting stage of the Annual Report.

Mr. Laske commented that the drafting of the Annual Report was an important exercise, not only because it described the activities of the Fund in the preceding financial year, but also because it received wide attention and interest in the financial world and among financial and economic professionals. The Annual Report had been increasingly quoted in recent years in speeches and articles dealing with the financial system. He agreed with the proposed outline, and he also agreed with Mr. Prowse that the 1983 Annual Report should discuss certain aspects of the current situation, in particular, protectionism and the external indebtedness of many member countries. With regard to the latter, it would be helpful if the Report could describe briefly the developments that had led to the large external indebtedness, and if it could also analyze the way in which the debt of some important countries appeared to have grown up in a somewhat haphazard and ill-considered way.

Commenting on the suggestion that the Annual Report should discuss the advantages and disadvantages of foreign exchange market intervention, Mr. Laske noted that an important study had recently been made on the subject and that it would be published in the near future. The question of whether and how the Fund should express its views on the issue would need to be discussed by the Executive Board, perhaps on the basis of a paper prepared by the staff. The subject was complex, comprehensive, and delicate; Directors should proceed with caution on such a sensitive matter.

Mr. Robalino suggested that the 1983 Annual Report should give more emphasis to the role of the international private banks in the financing of balance of payments deficits of many Third World countries.

Mr. El-Khouri asked whether the proposed discussion of external indebtedness would include the role of the Fund in making financial arrangements to deal with that problem. He also wondered whether it was intended to refer to the recent IMF Conference on International Money, Credit, and the SDR, or to summarize the views expressed at that conference.

Mr. Erb said that he agreed with the suggestion that the Annual Report should concentrate on key developments in the preceding year, in particular the current debt problem. He also agreed that a little more emphasis could be given to the issue of protectionism and the Fund's role in that regard. He shared Mr. Laske's views on the question of intervention. There should be a full discussion in the Board in the near future, before consideration could be given to policy pronouncements for inclusion in the Annual Report. A report on the conference on the SDR should be dependent on the Board's discussion of the outcome of that conference, although the Board's views on SDR allocation could be included in the Report.

Mr. Delgadillo said that he agreed with the suggestions that had been put forward to the effect that the discussion of external indebtedness should include the roles of the countries, the Fund, and the commercial banks.

Mr. Nair stated that he agreed that external indebtedness could be dealt with in the 1983 Annual Report in more detail than in the past. He hoped that the analysis would not be merely a statistical description of current problems, but that it would pay attention to the causes of the present difficulties, and that it might be supplemented by more detailed information on other flows, in particular the current status of official development assistance, especially to the low-income countries.

The Deputy Director of the Research Department observed that the Annual Report was the report of the Executive Directors and, as such, it could be used to express more forcefully the Board's views on surveillance and other important matters, if Directors wished. However, past experience indicated that it was often difficult to use the Annual Report for the expression of policy views on matters on which the Board had not yet reached final agreement. Sometimes, many hours were spent in drafting and discussion, followed by a decision, ultimately, to remove the passages on which agreement could not be reached.

On the other hand, if an issue, such as protectionism, was the subject of broad agreement in the Board, the Deputy Director continued, the Board's views could be expressed in the Report, and the staff would certainly be responsive to Directors' wishes in that respect. At the drafting stage, Directors could decide whether such an issue should be covered in a supplementary note, or in one of the chapters, probably Chapter 1 or Chapter 2. It was worth recalling that the use of supplementary notes had been dropped because much of the material that had been covered in that way was covered at present in the annexes to the World Economic Outlook papers. The possibility of bringing back such notes could certainly be considered; but the question might arise whether such notes were to be regarded as part of the Executive Board's report or whether they should be seen as notes by the staff that the Executive Board chose to append to its own report.

The fuller discussion of external debt, which a number of Directors had suggested, the Deputy Director of the Research Department added, could be appropriately included in both Chapter 1 and Chapter 2 of the Report.

The conference on the SDR could be mentioned in Chapter 3, which would describe the activities of the Fund, perhaps without discussing the views expressed at the conference. In that regard, it was worth recalling that the whole report of the conference would be published. A summary of the panel discussion that had concluded the conference was in preparation; it would be available to the Executive Board for information and for consideration of the publication plans.

Mr. Prowse noted that the question of overlapping discussion of issues in the Annual Report and in the World Economic Outlook publication was important. However, some issues, such as protectionism, deserved emphasis in both documents. It should also be borne in mind that the Annual Report was the report of the Executive Board, whereas the published World Economic Outlook paper was not a Board document. The latter might, therefore, be regarded as a vehicle for stating views on delicate issues on which the Board had not yet established a view. Nevertheless, it was important that the Annual Report, the one major statement by the Board each year, should state its views appropriately and with due regard to the sensitive nature of some of the issues. He suggested that the summary of the SDR conference discussion might usefully be attached to the Annual Report, as a means of giving it wide circulation.

The Chairman said that the staff would take account of the views expressed by Executive Directors. Protectionism, for example, would be discussed in detail, and consideration would be given to whether the discussion should be integrated into the Report or covered in a separate note. The question of external debt would also be analyzed, not only on a factual basis, but with an explanation of the genesis of recent developments and a description of the role of the Fund, the banks, and member countries. The issues would have to be addressed in an appropriately up-to-date way.

The Annual Report could not be a substitute for the Executive Board's discussion of matters of substance, the Chairman continued. It could not include, for example, policy recommendations on such issues as foreign exchange market intervention or on international liquidity before agreement had been reached among Directors. However, where there was a Board view on an issue, it would be stated clearly in an appropriate manner.

The Executive Directors approved the outline for the 1983 Annual Report, as set forth in EBD/83/112, Correction 1 (4/15/83).

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/63 (4/18/83) and EBM/83/64 (4/20/83).

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/104 (4/18/83) is approved.

4. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/83/106 (4/18/83) is approved.

APPROVED: September 16, 1983

LEO VAN HOUTVEN
Secretary