MASTER FILES
ROOM C-120 04

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/101

10:00 a.m., July 11, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
J. de Groote	
B. de Maulde	
	R. J. J. Costa, Temporary
R. D. Erb	
	M. B. Chatah, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	
	D. I. S. Shaw, Temporary
	C. Robalino
	H. Arias, Temporary
G. Laske	G. Grosche
	C. P. Caranicas
R. N. Malhotra	
	J. E. Suraisry
J. J. Polak	
	K. G. Morrell
G. Salehkhou	H. Alaoui-Abdallaoui, Temporary
F. Sangare	E. I. M. Mtei
	M. Toro, Temporary
	A. Lindø
	C. Taylor
	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present:

C. M. Nyirabu, Governor, Central Bank of Tanzania; F. Kazaura, Permanent Secretary to the Treasury, Tanzania. African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; D. T. S. Ballali, T. T. Gibson, J. M. Jimenez, M. Reichardt, B. A. Sarr, J. D. Simpson, R. T. Stillson, A. C. Woodward. Asian Department: H. Neiss, Deputy Director; R. Baban, S. Ishii, K. Saito. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; A. K. Mitchell, T. Hatayama. Fiscal Affairs Department: R. D. Kibuka, J. R. Modi, C. A. Yandle. IMF Institute: D. N. Bista, Participant. Legal Department: W. E. Holder, Ph. Lachman. Middle Eastern Department: J. W. Rose. Research Department: E. A. Milne. Advisors to Executive Directors: E. A. Ajayi, C. J. Batliwalla, S. El-Khouri, S. M. Hassan, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: J. Bulloch, M. Camara, T. A. Connors, M. Eran, G. Ercel, C. Flamant, I. Fridriksson, M. Hull, H. Kobayashi, P. Leeahtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, G. W. K. Pickering, T. Ramtoolah, J. Reddy, J. Schuijer, D. I. S. Shaw, P. S. Tjokronegoro.

1. TANZANIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Tanzania (SM/83/124, 6/13/83; Cor. 1, 6/22/83; and Sup. 1, 7/8/83). They also had before them a report on recent economic developments in Tanzania (SM/83/125, 6/14/83; and Cor. 1, 6/22/83).

Also present for the discussion were Governor Nyirabu, Governor of the Central Bank of Tanzania, and Mr. Kazaura, Permanent Secretary to the Treasury.

Mr. Mtei made the following statement:

> The Tanzanian authorities would like to express their appreciation for the staff's analysis of the economic and financial situation in Tanzania since the last Article IV consultation, which as Directors will recollect, took place in September last year. The authorities recognize, as does the staff, that the situation has remained extremely difficult, and their preoccupation over the past year has been to evolve lasting and workable solutions to correct the internal as well as the external imbalances. The authorities agree with the staff on most of the types of measures that need to be taken, but differ on points of magnitude, emphasis and timing, and it is my intention to explain some of these differences in this statement. At the outset, however, they would like to state that they welcome cooperation with external agencies to facilitate an early resolution of these problems even though in the ultimate analysis, a sustainable economic growth will depend on domestic policies and their proper management.
>
> The national accounts estimates released by the authorities during the presentation of the 1983/84 budget, now before Parliament, indicate that real GDP declined by 3.2 percent in 1982 following a decline of 1.7 percent in the previous year. The decline appears more pronounced in the agricultural and manufacturing sectors reflecting basically the inadequate supply of imported inputs--such as raw materials and spare parts--owing to the paucity of foreign exchange. The decrease in agricultural production coupled with a lack of adequate transport facilities also adversely affected the domestic supply of raw materials for industry. Consequently, inflationary pressures persisted with the consumer price index rising by about 28.9 percent in 1982.
>
> The financial position of the Government, though still tight, showed considerable improvement in 1982/83 as revenue expanded from T Sh 9,813 million in 1981/82 to T Sh 11,250 million while expenditure was contained to almost the same level as had been budgeted. The improved revenue performance reflected to a large extent income tax measures that had been taken in the course of the financial year as well as success in administrative measures

to collect past tax obligations. As a result of this favorable revenue outturn domestic bank financing is now estimated to be T Sh 4,206 million, almost equivalent to what had been anticipated in the budget despite a decrease in foreign grants.

The external payments position experienced further strains as the overall balance of payments registered a deficit of $127 million in 1982 compared with the modest surplus of $13 million in 1981. This was due mainly to the adverse external environment and the low volume of commodity exports resulting from the general decrease in domestic production. In the circumstances, Tanzania incurred further external payments arrears in 1982 amounting to $108 million.

The authorities, aware that this difficult financial and economic situation has persisted for too long a time and cannot be allowed to continue much longer, are determined to initiate and continue implementing measures that should arrest further declines and restore growth in the medium term. In this regard, they are actively discussing with the World Bank and the Fund with a view to concluding workable and comprehensive programs within the context of the Structural Adjustment Program which was launched last year and to which reference was made in the 1982 staff report. In the 1983/84 budget, the authorities have outlined the major policy instruments that will be applied to achieve the stated objectives. These instruments include producer pricing and general pricing policies, the exchange rate, and interest policies.

In the agricultural sector the Tanzanian authorities have held extensive discussions with the World Bank on the recently completed study on this sector. Together with the findings of a Presidential Task Force on National Agricultural Policy, the authorities are already putting in place a comprehensive set of measures to foster recovery, as contained in the Agricultural Policy Paper adopted by the Government. They are undertaking institutional changes that should lay the foundation for the effective implementation of an appropriate adjustment program. These include important changes in land tenure aimed at providing long-term rights to land holdings that should encourage land improvement. While the small holder, peasant, farmer will remain the main producer of crops for both export and domestic consumption and Government will intensify, emphasis will also be put on improving and increasing investment in large-scale state farms. In addition, private sector large-scale farmers will continue to play their role, albeit small, in the production of crops mainly for export.

It is important to point out that the authorities, while accepting the staff's view that producer prices have to be adequate to encourage increased output, consider that pricing policy is only one element in an essential package. In order to facilitate recovery and a take-off in agricultural growth, Government has redirected investment in this sector so that greater emphasis will be placed on improved extension services and research, infrastructure such as feeder-roads, prompt availability of essential inputs and credit, facilities for efficient marketing of produce and prompt payment to farmers. In this connection 26 per cent of the 1983/84 development and recurrent expenditures will be devoted to the agricultural sector. In addition, consumer goods will be made more easily available in the rural areas.

Meanwhile, additional measures have been taken in 1983/84 to encourage production by raising the prices of a variety of crops. For export crops, as the staff explains, the authorities have difficulty in accepting the proposal that prices should be raised in real terms by 30-50 percent in order to motivate farmers and prevent them diverting into other activities, including farming for subsistence and/or foodcrops. First, although production for export has stagnated or declined, it is not correct to assert that there has been a shift in favor of foodcrops since production for food has also declined. There are therefore other factors involved. Second, a massive price rise of almost 80 percent in nominal terms would distort intersectoral and intrasectoral incomes and would not in any case bring about a commensurate jump in the quantum of production of export crops. Perhaps it should be emphasized that Government desires an all-around balanced increase in agricultural production--of foodcrops as well as exports. In order to give the required boost to exports, therefore, it has adopted a policy guaranteeing a return to the farmer of the equivalent of 75 percent of the gross foreign exchange receipts for his crop or an annual real increase of 5 percent, whichever is the higher. My authorities consider that this policy should place the right emphasis on this vital sector; indeed, it places the agricultural producer for export in a special category in that it is he only who is guaranteed a real increase in spite of inflation.

Regarding this policy, the Government has announced a 40 percent nominal raise in the 1983/84 producer prices for the five main export crops of coffee, cashewnuts, tea, cotton, and tobacco. It is noteworthy that, compared with the prices which obtained in 1980/81, the new prices for the 1983/84 crop year are an increase of between 71.4 percent in the case of tobacco and 151.4 per cent in the case of robusta coffee.

As regards foodcrops, similar measures to be taken on the price side will be announced shortly. The intention is to ensure that the country attains self-sufficiency in food production at the earliest opportunity.

Mention should be made here that the increase in the producer prices of 5 percent in real terms for export crops during 1983/84 will entail a total operational loss of T Sh 785 million on the part of the crop authorities and marketing agencies. This loss is in spite of the 20 percent devaluation of the shilling effected in June. The authorities have set aside in the 1983/84 budget a sum of T Sh 500 million to meet part of this loss, but they consider that the balance of T Sh 285 million should be covered by improved efficiency on the part of the agencies. Indeed, if the international commodity markets improve significantly as the global economic environment improves, there may well be a lesser call on public funds for this purpose than is earmarked in the budget. I should stress that my authorities have chosen this method of dealing with the losses of the marketing agencies rather than through an exchange rate change, so as to retain the initiative and drive to improve the agencies' efficiency, and also because a larger devaluation of the shilling would have had wider and more far-reaching repercussions on the rest of the economy.

On the specific question of exchange rate policy, the Tanzanian authorities consider that the exchange rate is a vital tool for management, to be used not only in the allocation of resources between sectors of the economy, but also to maintain competitiveness. Recognizing the various factors that influence and/or are influenced by the exchange rate, the Government devalued the shilling by 20 percent on June 6, 1983. The authorities have further indicated that they intend to continuously review this situation and where appropriate and necessary make further adjustments. Specifically, they consider that a further adjustment in fiscal year 1983/84 of up to 10 percent might be feasible within the context of an adjustment program supported by the Fund.

On the question of subsidies and pricing policies, the Tanzanian authorities have agreed that the subsidy on sembe (maize flour) will be reduced gradually. As a first step, they have maintained the subsidy in the 1983/84 budget at the same level as it was in 1982/83 despite a proposed 50 percent increase in the producer price of maize and other cost increases. This has implied a substantial increase in the price of sembe. It is appropriate to mention that the Tanzanian authorities have also undertaken to review all other subsidies with a view to taking necessary action to reduce budgetary support to official entities.

In this connection, it may be noted that the 1983/84 budget is aimed at increasing efficiency and productivity while reducing the operational costs of the public sector. Accordingly, measures have been adopted to contain government expenditure by, among other things, reducing subsidies to local authorities. For example, transfers to Urban Councils have been reduced by 34 percent. However, the Councils will be allowed to collect their own revenues in order to finance their activities. In light of my authorities' intentions to review all other subsidies, other public sector enterprises should be able to introduce such self-supporting measures. At the same time, efforts are being made to exercise more effective control over expenditure. Furthermore, Government has halted further recruitment into the public service with the exception of specialized personnel. It has also withheld the general increase in wages and salaries in the 1983/84 budget, and has indicated a willingness to take additional measures to cut down expenditure should it become necessary.

On the revenue side, a review of the income tax law is under way in order to minimize tax evasion. Meanwhile, certain amendments have been made that should make capital gains tax rates more progressive. They have introduced a rate of 30 percent to be applied on capital gains of between T Sh 100,000 to T Sh 500,000 and 45 percent to gains exceeding T Sh 500,000. A rate of 20 percent still applies on gains of less than T Sh 100,000. In addition, the rates of withholding tax on management and professional fees, interest, etc., have been raised while penalties and interest charged for noncompliance have been increased to take into account the cost of administration. These measures are expected to yield additional revenue amounting to T Sh 500 million in a full year. Other revenue measures include an increase in the sales tax on petrol and a doubling of the tax on saloon cars. A 5 percent levy on electricity and telephone services has been imposed, while a 100 percent customs duty is to be applied on concession prices for crude oil, petrol, and other petrochemical products.

In the monetary sector, the authorities have indicated their intentions to reduce recourse to domestic bank financing of the budget deficit in line with the need to contain inflationary pressures in the economy. The measures taken in the fiscal area should assist in attaining this objective. With regard to interest rate policy it is agreed, as the staff report points out on page 25 that "interest rates are not the sole or even the most important factor in determining the level of national savings...." In the particular case of Tanzania, the authorities are extending the banking infrastructure in the rural areas as a means for mobilizing domestic financial resources. In the meantime, they are examining the possibility of selective increases of deposit rates following the general review effected on July 1, 1982.

The balance of payments position in the short term would be greatly assisted by efforts to mobilize resources from bilateral as well as multilateral sources such as the World Bank and the Fund. This should ease the flow of imports needed to raise production in agriculture and industry in the medium term. The authorities believe that discussions now under way with the Fund will lead to agreement on use of Fund resources by Tanzania.

With regard to external debt, the authorities have almost completed the compilation of comprehensive and up-to-date data on the volume and structure to provide a clearer picture of Tanzania's future debt service. Based on recent estimates made by the authorities, the debt service ratio in 1982 was 23.7 percent against 32.6 percent shown in the staff report. The authorities expect an increase in the debt service to about 48 percent in 1983 as opposed to 58 percent projected by the staff.

In conclusion, I should like to sum up by restating that the economic and financial situation in Tanzania has been under severe strain over the past few years. The Tanzanian authorities have now however carried out extensive studies, and are implementing wide-ranging and strong measures designed to rehabilitate the economy. Some of the measures the authorities are taking need, however, to be buttressed by a Fund-supported program in order for the economy to consolidate and take off on a sustainable basis. I should further note that on a number of points of policy measures, the authorities have expressed preference for approaches which are not the same as those of the Fund staff in terms of magnitude, emphasis, or timing. However, they have been candid in their explanations and there is no doubt that they harbor genuine fears regarding the repercussions of some of the proposals for action. I feel it would be appropriate for Executive Directors to examine the cogency of their case and offer guidance on how the staff could further pursue the discussions in order to reach agreement with my authorities. In any case, I urge my colleagues to facilitate the earliest possible discussion of the situation, since any further delay in resolving the problems can only exacerbate them.

Extending his remarks, Mr. Mtei noted that he had attempted to explain in his statement why the Tanzanian authorities placed emphasis on certain aspects of policy and why their emphasis was somewhat different from that of the staff. The authorities had genuine fears about the repercussions of certain of the proposals put forward but were open-minded on the major outstanding issues and were prepared to begin negotiations immediately with the staff with a view to having the Fund participate in and strengthen the adjustment program currently being implemented. The senior officials from Tanzania who were present at the meeting would be able to clarify some of the differences between the authorities and the staff on the outstanding policy issues.

Mr. Laske observed that the staff report made depressing reading. The Tanzanian economy was in deep distress, and economic policy was in a state of disarray. On the occasion of the 1982 Article IV consultation with Tanzania, Executive Directors had expressed grave concern about the continued deterioration of the economy, and it was alarming that that trend had continued unabated throughout 1982 and into 1983. He was in full agreement with the staff that the policies currently being pursued by the authorities were unlikely to produce any improvement.

By the end of 1982, the foreign exchange reserves of Tanzania had been all but exhausted, Mr. Laske continued. Substantial payments arrears had accumulated, and imports had been at a level insufficient to sustain the normal operation of the economy. The staff had provided clear evidence of the large internal and external imbalances and had noted that, while exogenous factors had played some role in the deterioration of the economy, the imbalances were mainly due to an inappropriate and ineffective approach to economic problems. The growing demonetization of the economy and the widespread development of black markets were evidence of the inadequacy of the measures taken thus far. Moreover, the well-intentioned emphasis that the Government had placed on social issues in formulating economic policy had not served to improve the lot of the poor; rather, it had led to pervasive controls on most economic activity, severe price distortions, and a deep erosion of incentives.

The central elements of Tanzania's problems were the wide overvaluation of the shilling and totally inadequate producer prices for agricultural products and manufactured goods, Mr. Laske remarked. The long-standing refusal of the authorities to correct those fundamental distortions had thrown public sector finances out of balance, led to monetary overexpansion, brought about shortages of almost all consumer products, and seriously affected the distribution of income. In the process, the manufacturing facilities--which had been poorly maintained--had become inoperative, and the country's infrastructure had disintegrated.

The increase in producer prices contemplated for the 1983/84 crop season and the devaluation of the shilling in early June were measures that were far too timid to have any significant impact on economic development, Mr. Laske considered. He agreed with the staff that price corrections of a much larger magnitude were urgently needed. Given that the shilling had appreciated in real terms by more than 100 percent over the past 12 years, a substantial exchange rate correction was unavoidable. In his statement, Mr. Mtei had indicated that the authorities might be willing to move in the direction favored by the staff, but he seemed to be pleading for a gradual approach. In his own view, gradualism was unwarranted and dangerous; unless the Tanzanian authorities were prepared to move promptly and decisively to correct the central elements of the economic problems, he could see no sound basis for the use of the Fund's resources.

Mr. Polak considered Tanzania's story to be a tragic one. Despite the country's great agricultural potential, its agricultural output and exports had fallen each year for more than a decade. The authorities had pursued high aims for the development of the population and had in fact achieved some progress in the social field: literacy was relatively high, there was a large supply of doctors in the country, and the life expectancy was longer than in many other countries in the region. However, the structure of the Government was such that there was no longer any income to maintain those improved living standards; indeed, even imports of medicine would need to be cut because there was no longer money available to pay for them. Tanzania was a country that had aimed at a socialist and egalitarian society in which the necessities of life would be available at low cost to all its people; unfortunately, the country was currently unable to meet those goals because of a failed distribution system that was due to inadequate official pricing for supplies. As a result, most supplies were moving through illegal channels, and large black market profits escaped taxation, leaving a shrinking official revenue base.

It was also tragic that the Government had maintained its stance against the obvious economic remedies to its problems, Mr. Polak commented. There was no need to search for remedies in the western industrial countries; it was sufficient to look toward the neighboring successful countries in Africa--such as Uganda--or other socialist and communist countries in Eastern Europe or in Asia to see that there were benefits to be reaped from adequate pricing. Instead of following those successful examples, however, Tanzania had chosen to carry out an intensive campaign against hoarders and black marketeers and to introduce rationing.

Another tragic element in Tanzania's story, Mr. Polak noted, was the fact that, while the country's lofty objectives had in the past found widespread response and generous support from abroad, long-standing aid programs were currently in jeopardy. Donors were becoming increasingly aware that their aid would not, in the present economic climate of Tanzania, lead to the needed economic development.

It was against that bleak background that the Fund's consultations and relations with Tanzania had been proceeding for some time, Mr. Polak said. The authorities had attempted to explain some of the problems by pointing to the symptoms of the disease; but it was the disease itself that needed to be tackled. He agreed with Mr. Laske that the effort to eliminate the symptoms--for example, by applying more and more stringent domestic measures, including rationing--had proved ineffective for more than a decade, and the more recent concessions to a realistic approach made by the authorities remained inadequate. The steps that were required had been clearly set out in the staff paper, and he fully supported the appraisal. In the circumstances, however, the Fund had no other option than to continue to be prepared to exercise patience and to keep open the lines of communication with the authorities, in the hope that they would not wait too much longer to move toward a constructive approach to their difficulties. Only if they did so would the Fund, and foreign donors, be ready to assist them.

Mr. Erb remarked that, like others, he was gravely concerned with the economic situation in Tanzania. Since the previous Article IV consultation, when the economy had been described as having reached "severe crisis" proportions, the situation had deteriorated further. He was in broad agreement with the staff's evaluation of the economy and could support the policy recommendations. There was an urgent need for a comprehensive reorientation of economic policy to be more responsive to market forces and to favor agricultural production. The areas in which economic policy shifts appeared most needed included agricultural producer prices, exchange rate policy, consumer price controls, and subsidization of parastatals.

No policy change was more clearly needed at present than a substantial rise in producer prices and a firm commitment to promptly adjust prices in future to offset the effects of inflation, Mr. Erb continued. The recent increases in producer prices had been inadequate; they had served only to arrest the deterioration in prices and had not begun to restore them to appropriate levels. A significant real increase in farmgate prices was essential to encourage increased production. As prices paid for agricultural products had fallen behind the pace of inflation, farmers had had less and less incentive to grow crops for sale to the official marketing boards; they had reverted to subsistence farming, had turned to smuggling crops across borders or had engaged in direct sales to cities. As a consequence, the Government had lost both foreign exchange receipts and tax revenues.

The Tanzanian shilling had appreciated strongly in real terms from 1979 through early 1983, Mr. Erb observed. The recent 20 percent devaluation had done little more than correct the appreciation that had occurred since the previous Board discussion; it was clearly important to return the real effective rate at least to the 1979 level. Without a further significant exchange rate depreciation, Tanzania would face the prospect of continued large-scale smuggling, a limitation on the ability of marketing boards to pay remunerative producer prices, and lost tax revenues.

Tanzania's price controls were not working to hold down the consumer price level, as a growing proportion of sales was occurring in parallel markets at prices several times the official prices, Mr. Erb remarked. Given the wide gap between official prices and those actually paid by most Tanzanians, there appeared to be considerable scope for raising official prices without substantially raising the actual price level.

Public enterprises, including the marketing boards, were showing signs of becoming increasingly less efficient and productive, thus forcing ever larger government subsidies, Mr. Erb commented. The growing inefficiency of the marketing boards in transporting and storing cash crops was reducing the resources available to those boards with which to pay producer prices to farmers. The losses of the parastatals were also leading to delays in maintenance and repairs; in 1982, for example, there had been serious delays in processing and exporting both cotton and coffee. Moreover, the recent decision to turn over local crop purchasing and storage responsibility to village governments did not deal with the fundamental inefficiency of the crop marketing boards, since the Government continued to require that onward sales should be made only to regional and national marketing boards.

With regard to the issue of a possible Fund-supported adjustment program, Mr. Erb considered, first, that major actions in the required policy areas would need to be taken by the authorities at the beginning of any program. Major policy changes were necessary if Tanzania was to achieve a sustainable current account position and real domestic economic growth rate, and the length of the adjustment period would be defined by the pace and extent of the policy changes. Hence, the question of whether the Fund should commit resources in support of a program was dependent upon whether the institution could be assured that the adjustments were likely to take place within a period that was consistent with the temporary and revolving character of the Fund's resources. Second, it was important to be assured that, during the adjustment period, there was adequate financing from other sources, including bilateral and multilateral assistance. Third, the Fund should be sure that the World Bank viewed Tanzania's investment program as consistent with the aim of achieving a sustainable balance of payments position along with real domestic economic growth. Many of the policy adjustments recommended by the Fund staff--in particular, those concerning producer prices and exchange rates--would have a more rapid and significant impact if, for example, government investments were directed to those sectors that became more competitive as price and exchange rate restrictions were removed. In light of the differences between the Fund staff and the authorities on the policy changes necessary to exert a decisive influence on Tanzania's balance of payments position and its domestic growth prospects, it appeared that an agreement on a financial arrangement with the Fund might not be imminent. However, the Fund should keep open the lines of communication with the Tanzanian authorities.

Mr. Shaw remarked that the key issues in the Tanzanian case concerned the extent and pace of the adjustment necessary to resolve the economic difficulties. In its appraisal the staff had confirmed the serious nature of Tanzania's problems and clearly demonstrated that the policies followed by the authorities over the past decade had resulted in a gradual deterioration of economic activity. He agreed with the staff that the poor performance of the economy over the period had only partially been the result of exogenous factors; more important had been the maintenance of an inappropriate system of price relationships, exchange rates, and interest rates, which had produced disincentives and encouraged maladjustments in the economy. The authorities should therefore revise their policies, which had clearly been insensitive to basic market forces.

The Tanzanian situation provided a clear example of government intervention that had retarded rather than encouraged balance of payments adjustment and economic development, Mr. Shaw continued. The staff had outlined the fundamental measures that offered a solution to Tanzania's difficulties; in particular, further adjustments must be made in reducing the activity of an overburdened public sector, and greater reliance must be placed on market mechanisms in the setting of price relationships, including exchange rate and interest rate policies. While the authorities had begun to recognize the extent of the maladjustment of the economy, they would be successful in overcoming their problems only if they took prompt and realistic action in the direction recommended by the staff.

The latest staff papers on the Tanzanian economy painted a picture as dismal as that presented on the occasion of the previous Article IV consultation, Mr. Shaw observed. The only difference was that the situation had become exacerbated by the continued delay in adjustment. In that regard, he shared the concerns of Mr. Laske, Mr. Polak, and Mr. Erb that no significant progress had been made in adjusting the economy in the past year. Hence, it was important that the pattern of agricultural production should be reversed from subsistence farming toward export production through a realignment of domestic cash/price relationships and an adjustment of the exchange rate. Considering Tanzania's comparative advantage in agricultural products--particularly raw cashews--incentives through increased producer prices would have a substantial positive impact on both economic performance and the balance of payments. In that respect, the White Paper on the agricultural sector--which had recently been published in Tanzania--fell short of his expectations. The paper outlined the problems and the preeminent role that agriculture should play in the Tanzanian economy and indicated some willingness on the part of the authorities to implement reforms in a number of critical areas--such as land tenure and research extension--and to improve the marketing of export crops and the efficiency of the parastatals. Unfortunately, the paper lacked any specific policy priorities and planning for the agricultural system and did not go far enough in specifying pricing policies. The currently inappropriate agricultural producer prices--especially the prices of export crops in relation to subsistence crops--had caused Tanzania's present problems and should be deregulated. In that regard, he could support the staff's recommendation that the price of export crops should be raised by a substantial margin; a 5 percent real increase in prices would not be adequate.

On the fiscal side, the adjustment program would need to be supported by measures to reduce the budget deficit and the bank financing requirements of the Government, Mr. Shaw remarked. There were indications that the Government had failed to control expenditures adequately, and the stopgap policies that it had been employing to raise revenues and close the fiscal gap in the face of an overall decline in economic activity seemed unrealistic. Expenditures of the public sector enterprises had also reached unmanageable proportions, and moves toward improving the financial management of those organizations would be essential. Indeed, the projections suggested that the crop authorities would continue to face even larger deficits in future. In the circumstances, the authorities were being overoptimistic in believing that a significant reduction in the deficits was possible under their budget proposals, given the underlying distorted price relationships. Furthermore, official development assistance to Tanzania would likely not be as great as anticipated in the program projections, given the growing resistance by aid agencies to finance inefficient and inappropriate pricing policies. That resistance pointed to an even greater amount of bank financing than was currently projected, which could undermine the monetary targets and further exacerbate inflationary pressures.

Commenting on the balance of payments, Mr. Shaw observed that the ambitious projections put forward by the authorities could only be realized through large increases in exports. Exports of tea and tobacco, for example, would have to reach levels that had been achieved in 1978/79, and cotton production would need to be increased significantly, if the balance of payments targets were to be met. A reversal of the agricultural production trends of the past few years demanded a restoration of the incentives to producers of those export crops. Given the activities in the parallel market, the easiest way for the authorities to achieve that objective would be to allow the producer prices for the export crops to be determined by market forces, or for the crop authorities to set prices that were consistent with those in the parallel market. The currently controlled and artificially low prices must increase in order to encourage a shift from subsistence farming to export crop production, and a devaluation of the exchange rate was needed to increase the incentives to export through legal channels.

With inadequate levels of foreign exchange, diminishing prospects for higher levels of export revenues, and little likelihood of any increases in foreign assistance, the objective of increasing the capacity utilization of the manufacturing sector was unrealistic, Mr. Shaw considered. Without an increase in capacity utilization, the tax base would continue to shrink, thus making the budget objectives more difficult to achieve. In that regard, the authorities might have placed too much hope on the potential for a recovery in the agricultural sector and might have been overly optimistic about the level of tax revenues that would result. His own view was that they should adopt a realistic export policy that would generate foreign exchange.

It was to be hoped that the authorities would agree with the thrust of the staff's recommendations, which could form the basis for an eventual program with the Fund, Mr. Shaw commented. A number of prior actions would need to be taken in the area of both pricing and exchange rate policies before a program could be brought to the Executive Board. It was not clear that an increase in prices would disadvantage many of the poorer sectors of the economy, as the authorities had claimed. Even in the urban communities, prices were by and large set in the parallel market, and changes in the price relationships would only legitimize what was already happening. He agreed with Mr. Erb on the general policy changes and external financing that would be necessary if a Fund program was to be agreed. He was not optimistic that the external financing would be made available to Tanzania in the absence of major policy changes. Still, the authorities should be commended for settling their arrears with the Fund; their action could provide a positive foundation on which to begin negotiations toward a Fund program.

Mr. Taylor agreed that Tanzania faced a very difficult task in seeking to cure its severe economic ills, which, unfortunately, seemed to have intensified since the previous Article IV consultation. Exports and imports had continued to decline; external arrears were mounting; and economic activity was shifting into parallel markets and border trade. Those trends had disturbing implications for Tanzania's future economic growth. It would indeed be regrettable if the economy, with its great potential as a producer of cash crops for export, should revert to subsistence agriculture.

He was pleased that the authorities appeared to have recognized the importance of measures to rehabilitate the agricultural sector--as outlined in the recently published White Paper--and he noted that they had made some progress toward that end, Mr. Tayor said. They had, for example, managed to tackle some of the most glaring problems of administrative inefficiency in the marketing agencies, and they were taking steps to reduce corruption. However, far more important to the rehabilitation of the agricultural sector was the restoration of realistic domestic price relationships, a crucial factor in which would be the establishment of a realistic exchange rate for the Tanzanian shilling against other currencies.

It was clear that the measures adopted so far under the stabilization and recovery program had been insufficient to achieve the authorities' objectives, Mr. Taylor continued. The 20 per centdevaluation of the shilling in June 1983 had been a step in the right direction but could not by itself correct the current external and internal imbalances. The principal aim of exchange rate adjustment was to enable the agricultural marketing agencies to pay higher producer prices while, at the same time, achieving operating surpluses. Farmers needed an incentive to increase production of cash crops, and the marketing enterprises required more resources to rehabilitate the agricultural processing and marketing industry; the authorities' proposal to guarantee to the cash crop producers an increase of 5 percent per year in real farm prices fell far short of meeting those aims. The World Bank had apparently recommended that the increase necessary to give sufficient financial incentives to farmers should be in the range of 30-50 percent over 1981/82 producer price levels. Increases on such a scale would have to be accompanied by a substantial devaluation of the exchange rate if the marketing enterprises were at the same time to achieve a surplus on their own accounts.

It was understandable that the authorities were concerned about the possible inflationary impact of a large devaluation, Mr. Taylor said. However, recent studies suggested that many goods were traded in the parallel market at prices considerably higher than the official rate; if so, the inflationary impact would be lessened because the devaluation would mainly serve to bring official prices in line with those prevailing in the unofficial markets. The situation in Tanzania, which was characterized by disguised inflation because controlled prices were well below the actual prices at which many goods changed hands, had been found in a number of developing countries with seriously overvalued exchange rates. In those cases in which a sharp corrective adjustment had been administered, in the context of appropriate fiscal and monetary policies, the inflationary results had been considerably less painful than anticipated. A recent example was Uganda, where the inflationary impact of a major depreciation under a Fund program had been relatively short lived. Moreover, in the Ugandan case, the agricultural producers' response to a sharply improved price incentive had been positive and had pleasantly surprised the Ugandan authorities. It was true that the strong adjustment policies being recommended for Tanzania were likely to produce hardships for certain sectors of the population. However, those hardships would be minor by comparison with the long-term damage that would be unavoidable if the economy continued to regress.

If the Tanzanian authorities could not bring themselves to implement fully the necessary corrective measures because they feared adverse social consequences before those measures had begun to take effect, it might be wise to consider means of cushioning the more acute effects in the short term while preserving the essential thrust of the adjustment, Mr. Taylor commented. During the discussions of the 1982 Article IV consultation with Tanzania, his chair had suggested the possibility of a phased depreciation through the temporary adoption of a dual exchange rate system. It would be interesting to hear the staff's views on that alternative to a straight-line, one-shot depreciation. It was fair to say that the dual exchange system had worked as a temporary expedient in at least one other African economy. Any phased devaluation should follow three rules: first, it should involve a major initial adjustment to the official rate; second, the phasing should be strictly temporary, with an explicit commitment by the authorities to reunify the system speedily at a realistic level, which would thenceforth be maintained in real terms; third, any dual or multiple rate system should be constructed so as to benefit the agricultural sector, where the best hopes for export recovery lay. Given the size of the Tanzanian agricultural sector in total exports, the implication was that the range of items permitted to enter at a favorable rate from the consumer's point of view would have to be relatively narrow.

Decisive action on the exchange rate and on producer prices would need to be accompanied by fully consistent fiscal and monetary policies, Mr. Taylor considered. In that context, he commended the authorities' decision to introduce additional revenue-raising measures and noted that some constructive steps had already been taken toward that objective. However, the budget prospects for 1983/84 remained a matter of serious concern, as they were dominated by the forecast need to pay further large subsidies to the parastatal organizations. It seemed that the parastatals, or their successors, would have to generate cash surpluses if there was to be adequate finance for rehabilitation of the agricultural processing and marketing sectors; and, without adequate exchange rate action, it was difficult to see how such surpluses could be generated or how it would be possible to make progress toward improving the financial position of the public sector and reducing its inflationary claims on the banking system.

In sum, Mr. Taylor said, the authorities should be given credit for recognizing the need to take action to arrest the decline in the economy, particularly in the agricultural sector; however, if they were to succeed in correcting the present misallocation of resources, re-establishing the confidence of creditors and aid donors, and securing a long-term growth of the economy, they would need to take more decisive action than in the past. The staff's diagnosis of Tanzania's problems seemed correct, and the recommended measures were appropriate, although they might not be easy to implement. If ways could be found of cushioning the immediate impact of adjustment without losing its essential thrust, they should be brought into play. He encouraged the authorities to look toward the sort of vigorous adjustment advised by the staff within the context of a Fund stand-by arrangement. In that regard, management might wish to hold discussions with the Tanzanian observers present at the meeting to see whether there was a reasonable basis for the staff to visit Tanzania with a view to carrying out negotiations toward a stand-by arrangement.

Mr. Wang observed that the economic and financial situation in Tanzania had been under severe strain for a number of years. To correct the internal and external imbalances, the authorities and the Fund staff had held extensive and substantive discussions in search of effective solutions to Tanzania's problems. While divergent views persisted, they related mainly to the emphasis, magnitude, and timing of the measures that should be adopted.

Judging from the nature of the economic difficulties currently faced by Tanzania, Mr. Wang said, he shared the view of the authorities that all policies and measures designed to rehabilitate the economy should be well conceived and carefully implemented and that any social repercussions should be avoided. He hoped that further discussions would be held between the authorities and the staff with a view to reaching agreement on a program that could be supported by Fund resources.

Mr. Lindå indicated that his authorities largely agreed with the staff's analysis of the difficult economic situation in Tanzania and were concerned about the continued deterioration of the economy. They hoped that the protracted negotiations between Tanzania and the Fund would soon lead to agreement on a realistic adjustment program. He welcomed the recent devaluation as a step in the right direction, and he commended the willingness of the Tanzanian authorities to undertake further adjustment efforts. His own authorities appreciated the readiness and efforts of the Fund to reach an agreement based on realistic assumptions.

Mr. de Groote said that, like others, he was deeply concerned about the orientation of economic policies in Tanzania because those policies appeared to have compounded the difficulties faced by all primary exporters during the current global recession. The Tanzanian authorities had apparently failed to recognize that resource allocation could be so severely affected by an unrealistic pricing policy. The measures that had been adopted--including changes in land tenure and agricultural marketing arrangements--would be insufficient unless accompanied by modifications in the pricing policy and the provision of adequate incentives to farmers. In passing, he noted that the Fund and the World Bank had a somewhat different perception of the minimum price adjustments necessary; however, that difference of opinion should not be viewed as an indication that the Fund staff's position was in any way objectionable; each institution had its own particular concerns.

The staff had clearly substantiated its arguments about the necessary adjustments to the Tanzanian economy, Mr. de Groote continued. The successes achieved in the balance of payments position and in real income by various countries that had come to rely on market mechanisms, tended to highlight the problems in Tanzania where the authorities had applied policies that had led to massive real income reduction while intending to do the opposite. So long as the authorities failed to recognize the need to rely more on market-oriented mechanisms, the Article IV consultations with Tanzania would serve only to confirm to Directors the general position adopted by the staff. In conclusion, he hoped that the presence of the Tanzanian authorities at the current discussion would signal renewed efforts toward agreement on an acceptable Fund program.

Mr. Tshishimbi noted that the Tanzanian authorities had for more than a decade been unable to reverse the declining trend of the economy, and the trend had persisted throughout 1982 and into 1983, with falling real output and exports that had maintained pressure on the balance of payments. Despite the drastic curtailment of imports to a level that the staff had described as insufficient to sustain the normal operation of the economy, foreign reserves had been depleted, and Tanzania had been unable to avoid the accumulation of external payments arrears.

The continued weaknesses in production and exports had served to enlarge the adjustment effort that was required by the Government, Mr. Tshishimbi continued. In 1982, revenues had been increased by 14-15 percent above the 1981/82 level, and the growth in expenditure had been reduced. Indeed, as noted by the staff, the Government had made "a considerable effort to curb recurrent expenditures, even to the extent that there may have been substantially inadequate maintenance of existing facilities." As a result of their actions, the overall deficit on a cash basis had increased from only T Sh 6.9 billion to T Sh 7.8 billion in 1982, which was considerably below the budgeted level of T Sh 10 billion. However, the outlook for 1983/84 was not encouraging. The production and export of agricultural products--which constituted the main source of foreign reserves--were unlikely to increase, and the Government's new budget projected a further widening of the deficit, stemming from a 10 percent increase in overall expenditure. The balance of payments was thus likely to remain under strain in 1983 and beyond.

In the circumstances he had described, the Tanzanian authorities had come to understand that they had little choice but to continue the stabilization effort already begun in the public sector and to strengthen the overall economic base, Mr. Tshishimbi remarked. The authorities appeared to be committed to that goal and, in that respect, seemed to share most of the staff's recommendations. What was needed in the immediate future was a concerted effort to improve infrastructure and to create a sound basis for economic growth, particularly in the agricultural sector where resources continued to be underutilized. The Government seemed to be prepared to take the most difficult measures necessary to give a boost to the agricultural sector through land reforms, improvement in the marketing arrangements, and increases in producer prices where necessary. It was clear, however, that an increase in producer prices would not, by itself, generate major increases in output; the higher producer prices must be accompanied by measures designed to ensure that there was an appropriate environment conducive to a smooth marketing of agricultural products. Moreover, the price incentives should, at the time they were implemented, be accompanied by a shift in income distribution in order to avoid undue social or political tensions.

The recent 20 percent devaluation of the shilling was a positive step toward price stability, Mr. Tshishimbi considered, and the Government remained open minded about further action in the exchange rate area. With a concerted effort by the Tanzanian authorities and bilateral and multilateral aid donors, including the Fund and the World Bank, progress was possible. The Fund should clearly indicate to the authorities that it was willing to play its part in the effort.

Mr. Alaoui-Abdallaoui remarked that, while external factors had played an important role in reversing the trend of economic development in Tanzania and bringing about large external and domestic imbalances, it was undeniable that the general economic deterioration had been primarily due to insufficient adjustment policies and institutional and structural rigidities. Tanzania could no longer postpone the adoption of radical measures to correct the domestic and external distortions if the deterioration was to be arrested and sustainable growth was to be resumed. The important measures that had been adopted in 1982/83--as reported in the supplementary paper--showed that the authorities had begun to take a more decisive attitude toward adjustment, and the Fund should assist them in their efforts. The staff's recommendations for adjustment seemed to be reasonable, although account should be taken of the authorities' institutional options and of their concerns about the economic and social effects of the proposed policies. In that regard, it might be desirable to implement the staff's recommendations only gradually, possibly in the fashion suggested by Mr. Taylor with regard to the exchange rate.

Mr. Malhotra said that he shared the concern of others about the deterioration of the Tanzanian economy. The authorities and the staff were apparently in agreement on the areas where urgent action was necessary to begin correcting the domestic and external imbalances; in particular, emphasis should be placed on the agricultural sector, which accounted for a major portion of the output of the economy and where production had been declining over the years. The authorities were aware that effective steps needed to be taken to improve production, and they had agreed that appropriate pricing of agricultural output was important. They were also becoming increasingly aware that the exchange rate required correction. They had recently devalued the shilling by 20 percent; and they had indicated their willingness to devalue further--by around 10 percent--if warranted. Moreover, a considerable effort was being made by the authorities on the fiscal side, both to increase revenue and to contain expenditures.

Given that the areas for action had been identified and the authorities had taken some important steps in the right direction, Mr. Malhotra said, he hoped that discussions between Tanzania and the Fund and Bank would continue with a view to reaching agreement on a reasonable adjustment program. Further delay in concluding such a program could result in greater deterioration that might later call for more drastic measures. To make the dialogue successful, the authorities would need to continue to search for effective answers to the problems besetting the economy; at the same time, the Fund staff and management should be certain that the recommended pace and extent of adjustment was feasible.

Mr. Suraisry observed that the Tanzanian economy continued to face serious difficulties on virtually all fronts. He agreed with the staff that far-reaching policy changes were required if the aims of reversing the economic deterioration and restoring domestic and external confidence were to be met. Falling production of export crops had seriously reduced foreign exchange earnings and government revenue; hence, major changes were needed in the agricultural sector. The potential for increasing agricultural production in Tanzania was considerable, and it was encouraging to note that, with the assistance of the World Bank, the authorities had recently completed a major review of agricultural policies. The proposals to reform the system of land tenure and improve the efficiency of the marketing arrangements were welcome and, if implemented, should ease the physical and institutional constraints on future output growth. However, the changes would not be easy to implement and would take time to have an effect. More adequate financial incentives were also needed to encourage a sustainable increase in production, and those should form part of the overall strategy to rehabilitate the agricultural sector and reduce illegal trade.

There was considerable force in the staff's argument that a depreciation of the exchange rate would make it easier for the authorities to pay farmers adequate prices and to ensure that the marketing boards had sufficient surplus for investment needs, Mr. Suraisry continued. The real effective appreciation of the shilling since 1979 might have hurt the economy; and there were currently wide disparities between the rates in the official and parallel markets. The authorities' concern about the inflationary consequences of a devaluation were understandable, but the effect on domestic prices could be limited if the devaluation was supported by firm fiscal and monetary policies.

The need to strengthen the Government's financial position was urgent, Mr. Suraisry considered. The overall budget deficit was currently at an unsustainably high level, even though the authorities had made commendable efforts to reduce current expenditure. The scope for further cuts in expenditure was limited if basic facilities were to be maintained. Hence, priority should be given to reorganizing the finances of the public sector enterprises and the marketing boards, and development spending should be closely monitored.

On the external side, Mr. Suraisry observed, the immediate prospects were bleak. Export receipts were expected to decline further in 1983; the debt service ratio was projected to rise to around 50 percent of exports of goods and services; and the level of financeable imports was insufficient for the normal operation of the economy. In the short term, Tanzania would have to continue to depend heavily on assistance from abroad, although the maintenance of such assistance would depend upon the effectiveness of the authorities' adjustment measures and on the early establishment of a timetable for eliminating arrears. Finally, a Fund program could play an important role in the concerted effort to revive the economy of Tanzania, and he hoped that an agreement could be reached between the Fund and the authorities on that matter.

Mr. Caranicas agreed with previous speakers on the precarious economic conditions in Tanzania; he also was in general agreement with the staff appraisal of the Tanzanian economy, particularly the observations on agricultural policy, the overvaluation of the exchange rate, and the necessity for domestic resource mobilization through the banking system. The authorities were to be commended for their valiant efforts to find some common ground with the Fund in tackling their very difficult economic problems; their efforts represented a marked change in attitude from the days in which Tanzanian representatives had, in various international forums, criticized the Fund and its policy approach. The authorities were currently in broad agreement with the staff on most of the measures that needed to be taken; differences of view concerned mainly the magnitude, emphasis, and timing of the recommended steps. Taking account of the political and social difficulties involved in reversing economic policy, it was still fair to say that the pace of implementation of the agreed reforms had been too gradual. He hoped that the authorities could learn from the experience of other countries in similar situations that had been successful in implementing recommended policies and would continue actively discussing with the Fund staff workable and comprehensive programs. Then, with additional assistance from the World Bank and other bilateral donors, Executive Directors might be able to discuss anew the Tanzanian situation in terms that were less tragic than those he had heard from his colleagues.

The staff representative from the African Department, recalling a suggestion by Mr. Taylor that the staff and the Tanzanian authorities should search for solutions that might cushion the impact of a large unitary exchange rate change, noted that the staff had not been doctrinaire in its discussions with the authorities in pressing necessarily for a large unitary rate change. Such pressure would in fact have been inconsistent with past practice; indeed, in the case of a number of countries, the staff had accepted as the basis for a Fund program various changes that did not involve a unitary rate change. If a dual exchange rate system were to be agreed, however, it would be important to ensure that it was temporary, that it favored agriculture, and that it was neutral from the fiscal point of view.

Regarding the observation by Mr. de Groote of a possible difference of opinion between the World Bank and the Fund staff on agricultural producer pricing policies, the staff representative stated that, if a difference of view existed at all, it stemmed primarily from the nature of the two institutions. The World Bank tended to stress that pricing policy by itself was not sufficient but should be accompanied by wide-ranging institutional changes; the Fund, on the other hand, argued that institutional changes in and of themselves were not likely to be effective without an adequate increase in producer prices.

There was no scientific way of determining the appropriate level of producer prices, the staff representative continued. However, farmers were probably not likely to make the mistake of assuming that a large nominal increase in prices would make much difference to their real income; rather, they would be thinking in terms of real income changes and would be looking toward a sharp increase in what they perceived to be their real rate of return.

Commenting on the scope for a Fund program, the staff representative said that he wished to assure Directors that the staff had been and continued to be anxious to reach agreement with the Tanzanian authorities on a stand-by arrangement. However, the staff felt that it could propose a stand-by arrangement to the Board only if a decisive improvement in the balance of payments could be expected by the time that repurchases fell due. Tanzania, for its part, would be expected to have a comprehensive adjustment program and major adjustment efforts in place at the outset of the program. The staff had also considered it essential that the program be fully financed, at least in the first years, because a considerable increase in imports would be needed to rehabilitate the economy; that increase could be financed through external assistance from other multilateral and bilateral lenders. In that regard, the World Bank had indicated a willingness to provide nonproject assistance only within a framework of incentives and institutional changes conducive to speeding up the rate of growth of production and investment; that, in the staff's view, involved understandings on incentive structures with which the Fund was also concerned.

As for project assistance, the Bank was continuing to make proposals to its Board for lending where it considered that the implementation of projects was not jeopardized by deficiencies in the functioning of the economy and where investments were needed in the longer run in any case, the staff representative from the African Department indicated. The Bank staff had recently brought to the Bank Board proposals for the implementation of a sewage project and for a technical exploration of a mining project; moreover, it was expected that a proposal regarding the construction of a power project would shortly be brought to the Board. However, as matters were developing in Tanzania, the Bank staff was concerned that the scope for projects of that sort was becoming increasingly narrow as the functioning of the economy was steadily deteriorating. Hence, from the point of view of both the Bank and the Fund, a decisive change in economic policies seemed to be urgently called for.

Mr. Mtei said that he was certain his Tanzanian authorities would give consideration to the Executive Directors' recommendations for correcting the problems of the economy. Speaking personally, however, he felt that there might have been an excessive emphasis by Directors on the exchange rate and the parallel market in Tanzania. Simply adopting the black market rate against the dollar as the official exchange rate would not be an accurate way of reflecting the strength of the shilling because of the nature of the way things operated in Tanzania. He was not saying that the recent 20 percent depreciation had necessarily been sufficient; and, as he had earlier indicated, the authorities were open minded on all outstanding issues, including the possibility of a further devaluation of the currency. At the moment, they were considering an additional 10 percent, but were prepared to discuss and negotiate such a further change in the exchange rate within the context of a Fund-supported program, involving, among other things, a substantial injection of resources into the economy.

In attempting to secure greater production and reactivate the economy, the authorities had been pruning and restructuring the public enterprises with a view to controlling their expenditures and, in some cases, phasing out those enterprises that were not functioning properly, Mr. Mtei continued. They were also working to decrease subsidies to the public enterprises and hoping to divert the marketing activities to the cooperatives and to strengthen the management of those public enterprises that would remain functioning.

On pricing policy, the authorities held slightly different views from the staff on the extent of the needed increase in producer prices and the effect that any increase would have on national production, Mr. Mtei remarked. Still, they were prepared to discuss the matter and to re-examine their own position in consultation with the staff. In that connection, he explained that, although there was some illegal border trade as a result of inadequate pricing, the magnitude of that trade was not such that its effect on exports was significant. The staff had no figures available on illegal border trade--precisely because it was illegal--but the authorities did not feel that there was much activity in such trade, particularly in the major export crops, because they could not be easily transported in a country like Tanzania. He was not denying that production for export had decreased; he was only noting that the role of illegal border trade had perhaps been overemphasized.

The latest budget was currently before Parliament, Mr. Mtei observed, and the authorities were proposing to take tough measures to reduce government expenditure and the expenditure of the parastatals, to maintain wages despite the social problems connected with such a move in the face of fairly high inflation, and to restructure investment to concentrate on the rehabilitation or completion of some ongoing projects, while diverting any new investment into the directly productive sectors of the economy. As he had noted in his opening statement, some 26 percent of all capital investment would be concentrated in agriculture.

The Tanzanian authorities were particularly anxious to cooperate with international organizations like the Fund in an effort to arrest the deterioration of the economy that had been occurring for some time, Mr. Mtei commented. As evidence of their willingness to find solutions to the problems, the authorities had sent representatives to the Fund to explain their intentions and had invited the staff to Dar-es-Salaam for further discussions and negotiations toward a Fund program. He was happy to note that a number of Directors had found common ground between the staff and the authorities, which should serve as a basis for compromise and positive discussion so that a program could be presented to the Board at the earliest opportunity.

The Acting Chairman made the following summing up:

Directors generally endorsed the staff appraisal and expressed deep distress about the worsening trends in the Tanzanian economy that had reached critical proportions; the situation in Tanzania was characterized as "desperate," "highly alarming," and "tragic." These economic trends were reflected in a deep and prolonged decline in economic activity, reduced production of principal exports, a depletion of international reserves, a rising level of arrears and external indebtedness, a significantly inadequate level of imports, a deteriorating productive base, growing parallel market activity, and high inflation.

Directors recognized that a number of factors beyond the control of the authorities had contributed to the deteriorating economic situation. However, they stressed that the central cause for deterioration in the economic and financial position of Tanzania lay in inadequate domestic policy. Most notably, drastically inappropriate price relationships, including exchange and interest rates, had for many years retarded growth and balance of payments adjustment. It was noted that Tanzania had taken steps to improve the availability of basic necessities to the population, but Directors stressed that failure to take strong policy measures threatened the maintenance of social gains. Most Directors strongly emphasized the need for more realistic pricing policies, including exchange rate policy, as an essential prerequisite for arresting the deteriorating economic situation and resuscitating the economy. Directors took note of the recent 20 percent depreciation of the shilling; however, most of them considered the action to be inadequate and hoped that it would be only a first step toward decisively correcting the remaining substantial overvaluation of the currency. It was observed that, with appropriate monetary and fiscal policies, the inflationary impact of a substantial exchange rate depreciation would be short-lived. In any event the attendant increase in prices would not be much different from those currently obtained in the nonofficial markets.

Recent steps to improve the institutional arrangements and secure greater economies in agricultural marketing were observed, although a number of Directors stressed that such changes would be unlikely to bring about a rapid amelioration of the agricultural situation in the absence of substantial increases in farm prices in real terms. Concern was also expressed that the campaign against hoarding and illegal trade activities, while understandable in itself, would in practice lead to further severe declines in productivity. Directors considered that a more liberal trading environment in conjunction with realistic pricing policies was essential for improving allocative efficiency, stimulating growth, and, perhaps, curbing inflation.

Directors considered that economic policy in Tanzania must be conducted with a view to minimizing recourse to bank finance by the Government and the marketing authorities. Until such time as more domestic revenues are mobilized, government expenditures needed to be curtailed. However, given that the Government was unable at present to make maintenance expenditures, revenues needed to be enhanced. Directors noted that the adoption of more appropriate pricing policies would be crucial in this regard, partly by expanding the tax base and by reducing or eliminating the losses of public enterprises and marketing authorities.

Directors observed that, notwithstanding the concessional nature of external assistance, including some conversion of loans to grants, scheduled debt service had become unacceptably high. The debt service ratio was not likely to decline from its present unsustainable level unless a major recovery in exports took place. Directors considered it important that steps be taken to regularize arrears and prevent their further growth.

Directors noted that the authorities were open-minded with regard to policy issues of concern to the Fund and expressed the view that it was important for the policy dialogue to be resumed soon and patiently continued. They hoped that the authorities would speedily adopt a financial and economic program that could be supported by Fund resources. Principal elements of such a program would have to include a substantial increase in real producer prices for export products, higher interest rates, strong economies in parastatal enterprises, improvement in the public sector finances, and a realistic exchange rate. The program would also need to provide for a far-reaching reduction in price controls and a liberalization of the distribution system. Directors believed that a realistic adjustment program would have to be supported by concessional assistance from the World Bank and other multilateral and bilateral donors; they warned, however, against overoptimism with regard to foreign assistance. It was also stressed by several Directors that very profound and vigorous changes in policy would be required in order for a program involving use of Fund resources to be undertaken. Any such program, they said, should assure a decisive balance of payments improvement by the time repurchases fell due.

Directors welcomed the reversal of the overcompensation associated with the compensatory financing facility repurchase effected in June 1981. Finally, it is expected that the next Article IV consultation with Tanzania will be held on the standard 12-month cycle.

The Executive Board adopted the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Tanzania's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Tanzania, in the light of the 1983 Article IV consultation with Tanzania conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Tanzania maintains restrictions on payments and transfers for current international transactions and multiple currency practices, as described in SM/83/125. The Fund urges Tanzania to pursue policies that would permit the elimination of these practices.

Decision No. 7464-(83/101), adopted
July 11, 1983

2. NEPAL - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Nepal (SM/83/129, 6/15/83). They also had before them a report on recent economic developments in Nepal (SM/83/145, 6/29/83; and Cor. 1, 7/7/83).

Mr. Panday made the following statement:

On behalf of my Nepalese authorities, I would like to express my sincere appreciation to the staff for its comprehensive and analytical report on the 1983 Article IV consultation with Nepal. My Nepalese authorities are broadly in agreement with the views and findings of the staff although they have some reservations about the staff's views on exchange rate matters.

The circumstances necessary for rapid economic growth were less favorable when the country embarked on the path of planned economic development in 1956. Nepal had, first, to contend with geographical configurations that impeded efforts to accelerate the pace of economic growth. The agricultural sector--the backbone of the economy--was vulnerable to unstable weather, and the basic infrastructural facilities--both social and economic--so indispensable to rapid economic development, were almost lacking. The first 25 years of Nepal's development efforts were, therefore, concentrated on building up essential social and economic infrastructure in order to create appropriate conditions for faster growth. As a result the course of economic growth has been uneven and slow.

During the early years, substantial achievements were made in creating basic infrastructural facilities. The main objective of the sixth Five-Year Plan, which is currently in operation, has been to secure optimal benefit from the facilities already created by expanding investment in directly productive sectors, such as agriculture, small and cottage industries, and the services sectors. This investment strategy has started paying dividends, as is evidenced by the performance of the nonagricultural sector in the past two years. The authorities have firmed up their resovle to vigorously continue the current investment strategies of diversifying investment on potentially productive sectors by undertaking needed additional measures in order to reach the growth target set in the sixth Five-Year Plan.

Recent developments

After two years of increasing output, the Nepalese economy suffered a setback in 1982/83 with the growth rate turning marginally negative and the balance of payments--traditionally in surplus--registering an overall deficit of SDR 33 million. The output of foodgrains, which accounts for the largest share in agriculture production, declined by 17 percent in gross tonnage, which was a greater decline than that in 1979/80. The continuation of growth in the nonagricultural sector and the vigorous efforts of the authorities to raise production of winter crops helped to prevent the overall growth rate from declining further. The investment program will continue to place greater emphasis on expansion of irrigation facilities and concentrate investment in those areas where transportation and banking facilities are prevalent. The authorities believe that these policies, geared to increasing productivity in the real sector, will place the economy on a stable growth plan.

Fiscal policy continued to be expansionary in 1982/83, resulting in larger fiscal deficits; the deficit is estimated to increase from 5.5 percent of GDP last year to 6.6 percent in the current year. The expansionary fiscal stance had an adverse impact on the balance of payments and, to some extent, on prices. To contain that trend, the authorities took a number of measures, including restraining expenditures on nonaiided projects, a sharp upward adjustment of administered prices of several commodities and essential services, and the curbing of wage increases, which will substantially reduce the burden on the budget. Administrative measures are being firmed up to improve tax collection, particularly from the trading sector. For 1983/84, the authorities have decided to prevent the fiscal deficit from exceeding the present level and to reduce bank borrowing to finance deficits to 2 percent of GDP, which is lower by 1 percentage point than the current year's borrowing. To attain that objective, a decision has been taken to float a special development bond with a higher interest rate to make it more attractive to the private investors.

With regard to monetary policy, the authorities are committed to maintaining the positive rate of interest on time deposits. The scheme of expanding banking facilities in more areas will be continued. The maintenance of positive interest rates and the expansion of banking facilities in new areas are expected to enhance further the mobilization of domestic savings through the banking sector.

Nepal has made considerable progress in rationalizing its exchange rate system. The dual exchange rate system was unified in September 1981, and the authorities adopted a flexible exchange rate policy by moving to the trade-weighted basket in early June 1983. Since December 1982, the Nepalese rupee has depreciated by nearly 10 percent against the U.S. dollar.

Both domestic developments and the unfavorable external environment adversely affected Nepal's external setor, turning the payments position to a deficit of SDR 33 million. The widening current account deficits mainly reflected the worsening developments in the trade account. Exports are estimated to decline by 39 percent this year as a result of the drought-induced drop in foodgrain output and the weak international demand for the Nepalese manufactures, particularly jute and handicrafts. On the other hand, imports are projected to rise by 18 percent compared to 12 percent in 1982. Emergency food imports to alleviate domestic shortages and the large import of capital goods connected with the implementation of the big development projects caused imports to grow rapidly and widened the current account deficit to 9 percent of GDP in 1982/83.

Historical trends show that Nepal has faced external difficulties as agricultural output, particularly of foodgrains, has declined. Since the main export products are agricultural, mainly foodgrains, the decline and the stagnation in foodgrain production lowers the volume available for export. Hence, the proper approach to the attainment of a stable and sustained balance of payments position lies in pursuing effective policies that keep stimulating productivity in the real sectors. The present investment strategies, which are oriented toward increasing productivity in the real sector, should greatly contribute to securing a sustained balance of payments position in the medium term.

Finally, my Nepalese authorities welcomed the staff's recommendation that the next Article IV consultation should be held before October 1984.

Extending his remarks, Mr. Panday observed that, according to the revised estimates for the current year's budget, total expenditure was estimated to be 24 percent less than the original estimate. However, current expenditure had increased by 35 percent, and the overall budget deficit was expected to be equivalent to 7 percent of GDP, reflecting the slow growth in revenue resulting from dislocation in economic activity and an increase in current expenditure in connection with the relief measures taken in the food deficit areas. Bank borrowing to meet domestic financing was expected to be somewhat more than 3 percent of GDP in the current year.

In the 1984 budget, which had been presented to Parliament on July 10, total expenditure was projected to increase by 37 percent in comparison with the current year's revised estimate, Mr. Panday continued. Within that total, current expenditure was expected to increase by 13 percent and development expenditure by 47 percent. The overall deficit was expected to remain at around 6 percent of GDP, while bank borrowing would be around 2 percent of GDP. Revenue was projected to increase by 40 percent in 1984.

The new budget also provided for the floating of special development bonds amounting to NRs 350 million and offering an interest rate of 12 percent, Mr. Panday said. No provision had been made in the budget for salary increases of government employees. The main objective of the new budget was to bring about stability in the economy by expanding and consolidating investment efforts in potentially productive sectors and stabilizing the external sector. To attain those objectives, the Government had decided to form a National Credit Council, the main responsibility of which was to recommend measures that would effectively increase the flow of institutional credit to the priority sectors and to supervise that process. Also, a scheme to guarantee export credit would be introduced to promote exports.

Mr. Hirao, noting that he was in broad agreement with the staff appraisal, considered that the authorities were to be commended for having successfully implemented measures to cope with the sharp decline in rice and other summer crops resulting from the severe drought in 1982/83. Those developments highlighted the importance of intensifying efforts to produce more foodgrains and other agricultural output both to meet the growing demand of the population and to increase exports. In the industrial sector, the authorities' policy of encouraging export-oriented cottage industries and import-substituting industries, which was being implemented under the Industrial Enterprise Act and the Foreign Investment and Technology Act of 1982, seemed to be appropriate.

With regard to fiscal policy, Mr. Hirao observed that the overall deficit and government borrowing from the banking system had risen further in 1982/83 to about 7 percent of GDP and 3 percent of GDP, respectively. While government revenue had increased at a rate of 16 percent, expenditures had grown at a rate of 26 percent, reflecting both the need to provide food and other relief to drought-affected areas and the 20 percent wage and salary increase for civil servants. Against that background, the authorities' intention to intensify fiscal efforts toward economic stabilization in 1983/84 was welcome. The measures to increase revenue--for example, increases in income tax rates in higher income brackets, increases in various registration and user fees, and the intensification of efforts to strengthen the tax administration--seemed to be appropriate.

On the expenditure side, he commended the authorities' plans to curb increases in wages and salaries and to reduce subsidy payments relating to rice and fertilizer. The effort to restrain development expenditures, mainly through suspending non-aid-financed projects, also seemed to be in the right direction. Moreover, the recent decision to raise interest rates on development bonds by 2 percentage points, effective from early 1984/85, should prove helpful in mobilizing domestic resources. He agreed with the staff that revenue mobilization efforts would need to be further intensified if the authorities' development program was to be pursued successfully.

On the monetary side, Mr. Hirao welcomed the authorities' intention to lower nominal interest rates only if inflation fell substantially below the rate currently anticipated. The proposed interest rate policy, together with the reduced government borrowing requirement for 1983/84, should help to bring the credit and liquidity situation into line with the objectives of the program.

Commenting on external policies, Mr. Hirao supported the recent unification of exchange rates, which had eliminated broken cross rates. The question of whether exchange rate policy should be used more actively to provide appropriate incentives for the export and import-substituting sectors was an important issue, since the scope for promoting those sectors through other measures was limited. While he could understand the authorities' argument that too rapid an adjustment of the exchange rate might not be wise, he tended to share the staff's view that some further policy action at an early date would be desirable to offset the cumulative loss in competitiveness that had been observed in recent years. In conclusion, he could support the proposed decision.

Mr. Malhotra observed that developments in Nepal in FY 1982/83 showed clearly the disruptive influence of bad weather on economies that were predominantly based on agriculture. There had been an overall decline in output with adverse effects on the budget, as revenues had fallen and expenditures had risen. The authorities were, in the circumstances, to be commended for the measures that they had taken to ensure larger production of the wheat crop--in light of the damage to the rice crop--and to ensure that adequate supplies of foodgrains were available so as to keep inflation under reasonable control. Given the major setback in the agricultural field, it had been only natural that the rate of inflation during the year should have continued at a fairly high level. Part of the pressure on prices was, of course, attributable to the fact that outlays had been rising for the past two years. Under normal weather conditions, the impact of those increased outlays would have been kept within reasonable limits; however, because of the recurrent disruptions in the economy, it was important for the authorities to make an effort to avoid imbalances in the fiscal area.

The increase in borrowing from the banking sector had showed a steep rise in 1982/83, Mr. Malhotra continued. However, he had noted from the staff report and from the additional information provided by Mr. Panday that the 1983/84 budget assumed a reduction of about 33 percent in government recourse to the banking sector. Moreover, the Nepalese authorities had taken other steps to contain nondevelopment expenditure, in particular by not providing for increases in salaries and wages in the 1983/84 budget.

On the matter of interest rates, Mr. Malhotra noted that the peaking of the inflation rate in 1982/83 might have turned some interest rates negative. If the projections with regard to inflation should prove correct, however, the vigorous pursuit of interest rate policy should result in positive rates on deposits in the banks. With regard to the exchange rate, he was happy to note the developments that had taken place in recent years. The exchange rate had been unified, and the authorities had managed the rate more flexibly. They had adopted a trade-weighted basket in June 1983 and had earlier effected a 10 percent depreciation of the currency vis-à-vis the U.S. dollar. As to the possibility of further changes in the exchange rate, he supported the cautious approach adopted by the Nepalese authorities, especially given the recent introduction of the trade-weighted basket, the composition and direction of Nepalese exports, and the high level of inflation. Considering the impact of inflation on the budget and several other areas of policy, such as interest rates, it was understandable that the authorities wished to maintain a cautious stance.

It was apparent that the decline in agricultural output in Nepal had been the major reason for the decline in exports, Mr. Malhotra said, noting that the Nepalese authorities had earlier approached the Fund for a purchase under the compensatory financing facility. Given the magnitude of the shortfall, he wondered whether the authorities were considering a request for further use of resources under that facility.

Mr. Salehkhou considered that the current economic problems facing Nepal were mainly twofold: the temporary, albeit recurrent, phenomenon of drought that had occurred in 1982 and to which the authorities had responded by cutting current and development expenditures and raising bank borrowing to maintain the already low standard of living; and the more serious problem of a lack of resources and inherent poverty, to which there was no clear-cut solution. External aid, favorable financing terms, and easy access to trade and financial markets might help to alleviate the latter problem, but it was clear that the economy remained highly vulnerable to external influences.

Following the 1982 drought, agricultural output had declined, inflation had risen, the food supply had dropped, and exports had declined, Mr. Salehkhou continued. As a result, the current account deficit as a percentage of GDP had almost doubled. He had the impression from the staff papers that the domestic policy measures adopted by the authorities to deal with the situation had not been sufficiently rigorous. A further slowdown in expenditure growth, reduced government borrowing from the banking system, further increases in administered prices, and an improvement in revenue were required. The authorities had of course taken some far-reaching measures; indeed, following the drought-induced deterioration in the food supply, the Government had taken steps to increase other food-crops to replace those affected by the drought. In the industrial sector, a new policy had been adopted in 1981 aimed at encouraging the development of export-oriented cottage industries and import-substituting units through tax and duty exemptions.

One reason for the weakened revenue situation in Nepal had been the stagnant real sector of the economy, Mr. Salehkhou observed. Land tax and other tax exemptions had been granted to alleviate the economic difficulties of the regions badly hit by the drought; however, within the framework of the 1983/84 budget, major efforts toward stabilization would be made. In particular, the overall deficit and borrowing from the banking system would be reduced, revenue-boosting measures would be implemented, and steps to strengthen tax administration would be intensified. As for monetary policy, total credit growth would be slowed, and the banks would be encouraged to channel resources to priority sectors and to increase the degree of monetization in the economy.

Although the authorities had already implemented a number of important measures and would act further along the lines suggested by the staff, Mr. Salehkhou noted, the low resource base and living standard of the population made it difficult to believe that the measures would do any more than correct the current imbalances. There remained a need to formulate a comprehensive medium-term strategy to address the fundamental problems. In that regard, continued participation by the World Bank should prove beneficial, and he had been pleased to note from Appendix III of SM/83/124 the number of IDA loans extended to Nepal. However, he wondered about the large percentage of undisbursed IDA loans, which he understood was connected with the low project absorption capacity of the economy. It might be preferable to consider projects to which the Nepalese economy--with all its features and characteristics--was more accommodating. Also, he had been surprised that the International Finance Corporation, which emphasized joint venture projects with the private sector, had extended only one loan to Nepal, which presumably was undisbursed. Perhaps a further strengthening of the private sector would allow the authorities to take advantage of the opportunities extended by the International Finance Corporation.

Mr. Erb stated that, like others, he could support the staff appraisal. Recognizing that the Government was making a significant effort to reduce its fiscal deficit, he would nonetheless stress the need for the authorities to remain at or below their target of 2 percent of GDP for government bank borrowing. He commended the authorities' decisions to defer additional increases in wages and salaries of civil servants and to reduce subsidies. There was a need to encourage greater mobilization of domestic resources to support the economic development program, and he was pleased that the authorities planned to pursue more flexible interest rate policies. He noted that they intended actively to encourage financial intermediation in rural areas by supporting an expansion of the commercial banking branch network.

Commenting on external policies, Mr. Erb welcomed the decision of the authorities to terminate the practice of maintaining fixed exchange rates simultaneously against both the U.S. dollar and the Indian rupee. He joined the staff in urging the authorities to pursue a flexible exchange rate policy in order to maintain competitiveness in both the export and import-substitution sectors, thus strengthening the balance of payments over the medium term. The level of international reserves in Nepal had fallen sharply, and that was a source of concern, particularly given the relatively steep drop in convertible currency reserves, a trend which underscored the need for the authorities swiftly to adopt policies that would return the economy to balance of payments equilibrium. Finally, he commended the authorities for having eliminated exchange restrictions.

Mr. Panday observed that Directors had expressed concern in the three main areas of fiscal, monetary, and exchange rate policy. With regard to monetary policy, the authorities had demonstrated firmness in maintaining positive rate of interest on deposits, although the rates on savings and other time deposits were low by comparison with the rate of inflation. While the authorities had experienced some difficulty in adjusting interest rates in line with the rate of inflation, the rates on time deposits had been kept at 13.5 percent. Some Directors had suggested that, since inflation had increased, the authorities should adopt a flexible interest rate policy in order to achieve the dual objective of mobilizing domestic resources and channeling them to productive sectors. During the mid-1970s, the Nepalese authorities had raised interest rates on time deposits by 60 percent and raised the lending rates, accordingly, to 18 percent or more. However, experience at the time had shown that it was difficult to increase interest rates in line with the rate of inflation because of the problems that arose when the interest rate was vastly different from that prevailing in India. When the authorities had raised the lending and deposit rates, the mobilization of domestic resources had been encouraging, and total time deposits had doubled in a short period of time; however, since the interest rate had been lower in the Indian market, most of the credit needs of the commercial traders had been met through suppliers' credit from the Indian market, and the banks had been forced to live with a high liquidity situation that had adversely affected their profitability.

In the area of fiscal policy, Mr. Panday noted, an expansionary approach had been adopted in the previous two years, mainly because revenue mobilization had been slow, dislocations had occurred in the economy, and certain adjustment measures had had to be adopted in order to improve the performance of the public sector enterprises. In 1982/83, there had been a substantial transfer of resources to the public enterprises in order to raise their capital base and reduce their need to borrow from the commercial banks, thus preventing crowding out of the private sector. It had also been considered necessary to raise the salaries of employees, which had been quite low. The previous major salary increase had taken place in 1965, with only small increases in 1973, 1976, and 1978; there was no regular cost of living adjustment to wages. The salary increases announced in July 1981 were mainly concentrated on those lower down the salary scale; but it was at the higher levels that pay increases were most needed to stimulate efficiency. A reasonable objective was to increase the salaries of the 5,000-6,000 gazetted officials over the following two years, even though it meant some increases in the fiscal deficits. In 1983/84, no provision was made to increase the salaries of the government officials, and the authorities had taken additional measures to reduce the deficits and lower bank borrowing. They had also decided to float special development bonds, offering a 12 percent interest rate, to attract investment in the private sector so that the borrowing requirement from the commercial sector could be reduced.

With regard to the exchange system, there were some differences of view between the Nepalese authorities and the staff, Mr. Panday observed. The Fund staff had indicated in its report that the authorities had already exhausted all options other than changes in the exchange rate to provide incentives to exporters and had suggested that the authorities should undertake adjustment measures at an early date in order to offset the cumulative loss observed in recent years. The authorities felt that caution should be exercised in the use of the index to compare the competitiveness of Nepalese exports. The composition of the commodity basket and the weight given to various commodities in deriving the price index were different for different countries; hence, the index might not correctly reflect the competitiveness of Nepalese exports. In 1982/83, for example, export unit prices--particularly for rice, jute, and carpets--had risen by more than the cumulative inflation rate between 1981 and 1983. As such, the authorities felt that there was no immediate need to undertake any further exchange rate adjustment measures. Still, they were open minded on the matter and had indicated a willingness to make changes where warranted.

When the authorities had adopted the dual exchange rate system in 1978, Mr. Panday explained, the dollar rate had been depreciated by 33 percent and applied to the purchase of exports; a similar rate had been applied for payment against imports. Experience over the period since that time suggested that the exchange rate had had no substantial impact on the production of traded goods; rather, the dual exchange rate had simply diverted goods away from one country to another, namely, from inconvertible to convertible currency areas, thus creating some problems for the Government. The authorities therefore believed that the real answer to improving the external sector lay in increasing the efficiency of the real sector by taking appropriate structural measures, such as those that had recently been adopted. Particularly in the agricultural sector, the Government had been placing emphasis on the expansion of irrigation facilities and the role of the Agricultural Corporation as well as on the expansion of investment activities of the commercial banks in priority sectors, particularly the agricultural and cottage industries.

The Acting Chairman made the following summing up:

Directors were in broad agreement with the staff appraisal. They noted that Nepal's economy had been adversely affected by a drought in early 1982/83; consequently, agricultural and overall output had declined, causing domestic supply shortages and a sharp decline in exports. The supply shortages, combined with a rapid demand expansion, had resulted in higher inflation and a turnaround in the overall balance of payments from its traditional surplus to a deficit. Directors expressed concern about the Government's heavy borrowing from the domestic banking system, which has been largely responsible for the persistent demand pressures. They noted new efforts by the Government to reduce such borrowing for 1983/84.

Directors welcomed the considerable policy efforts that had been made to overcome the economic difficulties in Nepal. In particular, they commended the authorities' success in averting a serious food shortage through concerted efforts to increase winter wheat production and mobilize food imports. They also welcomed the recently adopted measures to reduce the Government's bank borrowing, including restraint on non-aid-financed development expenditures, postponement of wage and salary increases in the civil service, intensification of tax efforts in several areas, and increases in administered prices. Those budget measures were considered necessary to constrain credit and monetary expansion to a rate consistent with a smaller external deficit in 1983/84; however, it was felt that even further measures were needed. An increase in the interest rate on development bonds was commended.

Directors stressed that development efforts should be supported by the provision of appropriate incentives for production, particularly in export and import-substituting sectors, and that domestic financing should be accomplished through savings mobilization--inter alia, by maintaining positive real interest rates--rather than by borrowing from the banking system.

Directors welcomed the recent adoption of a basket peg arrangement, which should facilitate a more flexible use of the exchange rate and prevent the re-emergence of broken cross rates. They considered that the use of exchange rate policy more actively to strengthen the economy and the balance of payments over the medium term would be an important way of strengthening exports and import competition and of correcting the deterioration of the balance of payments and the reserve position.

Given the early stage of development in Nepal, a comprehensive medium-term economic and development strategy was called for. Finally, it is expected that the next Article IV consultation with Nepal will be concluded by October 1984.

The Executive Board adopted the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Nepal's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Nepal, in the light of the 1983 Article IV consultation with Nepal conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the termination of the practice of simultaneously maintaining fixed rates vis-à-vis the currencies of two Fund members, a practice that has given rise to broken cross rates in the past.

Decision No. 7465-(83/101), adopted
July 11, 1983

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/100 (7/8/83) and EBM/83/101 (7/11/83).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/24 and 83/25 are approved. (EBD/83/181, 7/1/83)

Adopted July 8, 1983

4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/178 (7/7/83) is approved.

APPROVED: December 28, 1983

ALAN WRIGHT
Acting Secretary