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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/123

10:00 a.m., August 26, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
	H. G. Schneider
B. de Maulde	
	J. Delgadillo, Temporary
R. D. Erb	J. C. Williams, Temporary
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
	Jaafar A.
	M. Casey
	H. Arias, Temporary
	G. Grosche
G. Lovato	
	V. K. S. Nair, Temporary
	J. E. Suraisry
	J. Schuijer, Temporary
	K. G. Morrell
G. Salehkhou	
F. Sangare	E. I. M. Mtei
	M. Toro, Temporary
	I. Fridriksson, Temporary
	C. Taylor
Zhang Z.	Wang E.

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

Also Present

African Department: J. B. Zulu, Director; E. L. Bornemann, E. A. Calamitsis, F. d'A. Collings, A. Doizé, P. J. Duran, C. Enweze, G. Kalinga, T. P. McLoughlin, S. L. Rothman, E. Sacerdoti. Asian Department: H. Neiss, Deputy Director; A. N. Mansur, K. Saito. Central Banking Department: G. Hacche. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Kanesa-Thasan, R. K. Rennhack, P. M. Thomsen. Fiscal Affairs Department: S. Richupan, A. Tazi. Legal Department: J. K. Oh. Research Department: N. M. Kaibni, E. A. Milne, T. K. Morrison, A. Salehizadeh. Bureau of Statistics: G. A. T. Donely. Advisors to Executive Directors: A. A. Agah, P. Kohnert, H.-S. Lee, Y. Okubo, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, R. Bernardo, T. A. Connors, C. Flamant, J. M. Jones, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, J. Reddy, Shao Z., D. I. S. Shaw.

1. BURMA - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a request by Burma for a purchase equivalent to SDR 29.15 million under the compensatory financing facility (EBS/83/160, 8/2/83; and Sup. 1, 8/18/83).

Mr. Jaafar commented that the requirement of need was clearly established. Burma's deficit on current account had deteriorated and was currently equivalent to 7.6 percent of GDP, and its international reserves had dropped to the equivalent of less than one month's imports. Those positions largely reflected the weak external situation, in particular, weak world demand and low commodity prices, factors that were beyond the authorities' control. The staff was satisfied that the authorities would continue to cooperate with the Fund to seek appropriate solutions to the balance of payments difficulties. The authorities' commitment had been demonstrated by the various measures that they had undertaken, such as expenditure restraint and export promotion. In addition, Burma had successfully completed the stand-by arrangement with the Fund in 1982. There could be no overestimation of the export shortfall, equivalent to SDR 51.2 million, because it was based on actual export earnings. Burma's request was for a purchase amounting to only SDR 29.15 million, equivalent to 26.6 percent of its quota, increasing its outstanding purchases under the compensatory financing facility to 50 percent of quota.

Mr. Hirao remarked that Burma's balance of payments position had deteriorated between 1982 and 1983, largely as a result of the weak world market conditions for Burma's major export items. The current account deficit had risen to 7.6 percent of GDP and international reserves had declined sharply to less than one month's imports at the end of March 1983, clearly indicating the balance of payments need. The requirement of cooperation with the Fund was met through the authorities' continued efforts to strengthen public sector financing by expenditure restraint and revenue collection measures. It was encouraging that those efforts were expected to contribute significantly to reducing imports and to improving the current account position in 1983-84. Efforts to strengthen and to diversify Burma's export base were also welcome; they would promote sound economic development in the long run.

Commenting on the export shortfall, Mr. Hirao noted that export earnings in the year ended March 1983 had been significantly below the medium-term trend. The shortfall was mainly attributable to declines in the earnings of rice and forestry products. The former, which accounted for more than half of the total, had been caused by factors beyond the control of the authorities. World rice prices had declined sharply since the second half of 1981. During the shortfall year, the unit value of Burma's rice exports had fallen by 18 percent, with export earnings declining by 26 percent. The authorities' continued effort to raise the level of rice production was expected to result in increased export earnings. The staff considered that the shortfall in forestry products was mainly due to the delayed response by producers to low world market prices in 1981-82. The request met all the requirements of the compensatory financing decisions; he could support it.

Mr. Grosche said that he also could support Burma's request. The staff convincingly explained the balance of payments need and the temporary nature of the shortfall. He agreed that the reasons for the shortfall could be traced to factors largely beyond the control of the authorities. However, further information would be welcome concerning the "transportation difficulties" that had contributed to the shortfall of export earnings from forestry products. The authorities appeared to be acting in accordance with the recommendations of the Executive Board on the occasion of the previous Article IV consultation in December 1982 (EBM/82/163, 12/20/82). Perhaps more vigorous actions were required to reduce the public sector deficit. The staff seemed satisfied for the moment with the degree of stabilization of the budget achieved to date. He invited the staff to say whether it would recommend further action by the Burmese authorities in that area.

Mr. Erb said that Mr. Grosche's inquiry with regard to forestry products had raised the question of whether that part of the shortfall had been beyond the control of the authorities; however, he was satisfied that the total amount requested was less than the shortfall to which that question had referred. Therefore, while looking forward to the staff's comments on the question, he could support the proposed decision.

Mr. Lovato commented that the request met all the criteria for a compensatory financing decision. The balance of payments position was expected to improve as a result of the adjustment measures undertaken by the authorities, but it remained weak, and the shortfall appeared to be largely beyond the authorities' control. The staff appraisal of the policy stance was positive; it could be expected, therefore, that appropriate measures would be maintained to deal with the weak external position. Nevertheless, bearing in mind his chair's position that access above 50 percent of quota under the compensatory financing facility should not be conditional on a program agreed with the Fund, he wondered why the arrangement had not been made for the full amount of the compensable shortfall. The Executive Board was to discuss that issue in a few days; the proposed decision appeared to prejudge the outcome of that meeting.

Mr. Zhang stated that he agreed with the staff appraisal. He noted the Burmese authorities' stated intention to cooperate with the Fund to find appropriate solutions to the balance of payments problems as required.

Mr. Nair remarked that Burma's request satisfied all the requirements for a drawing under the compensatory financing facility. However, the request had a number of features that deserved comment. The compensable net export shortfall was SDR 38.4 million, based on actual, not estimated, data. The proposed purchase was for only SDR 29.15 million, an amount that limited the purchase to 50 percent of Burma's quota, whether by coincidence or not. As Mr. Jaafar had pointed out, Burma had been cooperating with the Fund. It had successfully implemented an adjustment program in 1981-82 under a Fund-supported stand-by arrangement. Furthermore, the fiscal year (FY) 1983/84 budget was based on the anticipated implementation of significant fiscal measures, and the Burmese authorities were also adopting appropriate action on the monetary side. It would be interesting to know, therefore, why the Fund was not extending to Burma the full amount that the country would be justified to draw under the facility, given the acute balance of payments need and the very low level of reserves. As Mr. Lovato had remarked, the Board would soon be discussing the guidelines for purchases under the facility, including the question of the appropriate criteria for access to purchases above 50 percent of quota. Had a judgment been made that Burma would not meet the criteria for a drawing above 50 percent of quota and that, therefore, the request should be limited to bringing Burma's purchases to 50 percent of quota?

Mr. Suraisry commented that he agreed generally with the staff appraisal. The request met all the requirements for a purchase under the compensatory financing facility, and he could, therefore, support the proposed decision.

Mr. Morrell said that he also supported the proposed decision. He agreed with those speakers who had wondered why the drawing was limited to 26.6 percent of quota, raising the total drawings made by Burma under the facility to 50 percent of quota. Burma's situation seemed to meet the criteria for a purchase above 50 percent, as outlined in EBS/83/171 to be discussed soon by the Board. The authorities had undertaken strong adjustment measures, they had recently concluded a successful program with the Fund, and the shortfall was mainly the result of external factors.

Mr. Casey observed that Burma should probably receive more than 50 percent of quota in the particular circumstances, as a number of speakers had commented, although such a judgment was partly contingent upon the answer to Mr. Grosche's question with regard to whether further action was required in the fiscal area. However, the Burmese authorities had cooperated very closely with the Fund, and for that reason they were in principle entitled to draw more than 50 percent of quota.

Mr. Fridriksson said that he too would be interested in knowing why the full amount of the shortfall had not been compensated. If the reason was insufficient policy action, it would be interesting to know more about such weaknesses.

Mr. Salehkhou remarked that he agreed with the staff's assessment of Burma's request and he could support the proposed decision. He too would be interested in knowing the answer to the question raised by Mr. Lovato, Mr. Nair, and other speakers.

The staff representative from the Asian Department commented that transportation problems had been present in Burma for some time. The staff did not have detailed information on the causes of the difficulties during the shortfall year, but it believed that a possible reason was a shortage of petroleum for inland transportation. It would discuss the matter with the authorities in Rangoon at the time of the forthcoming Article IV consultation.

Commenting on the amount of the request, the staff representative from the Asian Department said that the authorities' request had been for a purchase that would raise Burma's outstanding purchases under the compensatory financing facility to 50 percent of quota. That request had been made on the basis of preliminary calculations, before the exact extent of the shortfall had been known. The authorities might request a further purchase that would raise their outstanding purchases to beyond 50 percent of quota. If the authorities took that course, the staff would review the matter with them at the time of the 1983 Article IV consultation discussions, scheduled to be held in the second half of October. Those discussions would cover recent economic developments and policies, focusing in particular on policies in the fiscal area in light of the actual outcome for FY 1982/83. The staff would discuss with the authorities any policy actions required in the present fiscal year and in the medium term.

The staff representative from the Research Department remarked that the staff had applied the usual Executive Board policy in reviewing the member's policy stance. The present request represented an extension of an interest in the use of the compensatory financing facility expressed about a year earlier, at the time of the previous Article IV consultation. At that time, the shortfall had been small in relation to quota and, in the event, the drawing had amounted to the equivalent of 23 percent of quota. It had been expected at the time of the first drawing that the shortfall would increase in the course of 1983 and that the authorities would submit another request under the facility. Although the shortfall estimated in the paper before the Board was SDR 38 million, the proposed purchase was for SDR 29 million, an amount that would raise the outstanding drawings under the facility to 50 percent of quota. The requested drawing did not go beyond 50 percent because of the need for a current assessment of Burma's policies in order to satisfy the cooperation requirement for such a drawing. The authorities might raise the possibility of a further drawing at the time of the forthcoming Article IV consultation in October.

Mr. Jaafar noted that Directors had warmly supported the request, and that a number of them had suggested that it ought to have exceeded 50 percent of quota. He wondered whether, in light of the substantial adjustments that the authorities had taken and that they would continue to take, it was possible for the Board to authorize a purchase that would increase Burma's drawings to more than 50 percent of quota.

The Acting Chairman suggested that normal practice would be to adopt the decision as it stood, and for the staff to discuss with the authorities the possibility of a further purchase on the basis of more recent data at the time of the forthcoming Article IV consultation, which would be soon.

The staff representative from the Research Department stated that there should be an amendment to the second paragraph of the proposed decision, to read: "The Fund notes the representation of Burma and approves the purchase in accordance with the request."

The Executive Board then took the following decision:

1. The Fund has received a request by the Government of Burma for a purchase of SDR 29.15 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representation of Burma and approves the purchase in accordance with the request.

Decision No. 7503-(83/123), adopted
August 26, 1983

2. THE GAMBIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with The Gambia, together with a proposed decision concluding the 1983 Article XIV consultation (SM/83/165, 7/29/83). They also had before them a report on recent economic developments in The Gambia (SM/83/185, 8/15/83).

The staff representative from the African Department stated that recent information provided by the Gambian authorities indicated that the difficult economic and financial trends that had been anticipated in SM/83/165 had intensified. Provisional data indicated that, in the year ended June 1983, credit to the private sector and net credit to the Government had risen by 32 percent and 60 percent, respectively, compared with increases of 22 percent and 36 percent projected in the staff report.

The Gambian authorities had stated that the higher than projected expansion in credit to the private sector was the result of the delayed shipment of groundnuts and, hence, the late accrual of export proceeds, the staff representative continued. They added, however, that credit to the private sector had been reduced by D 13.2 million in July, and they expected further reductions in the following two months. They had also stated that part of the reason for the higher than projected expansion in net credit to the Government was the delayed payment of D 2.5 million in income taxes, which had been made only in the first week of July. The staff mission scheduled to visit Banjul in the following week would discuss those developments with the authorities.

The increase in credit to the private sector had been D 48.8 million above the target of D 220.6 million, the staff representative explained, wholly as the result of an increase in the Central Bank's credit to the Gambia Produce Marketing Board (GPMB) reflecting the slow transportation of groundnuts and the accrual of export payments. If, as the authorities suggested, the excess was wholly the result of delays in groundnut shipments, it was probable that credit expansion to the private sector would resume its anticipated course.

Commenting on the expansion of credit to the Government, the staff representative noted that the financing of the development budget had been explicitly predicated upon the assumption that all the local financing expected in fiscal year (FY) 1982/83 would materialize. Local funds comprised three elements: financial savings; cash loans; and the amount of bank financing provided for in the program. During the year the authorities had received bridging finance from the Central Bank. Unfortunately, the STABEX--export earnings stabilization facility of the European Community--entitlements that the authorities had expected to cover the local cost components of development expenditures had not materialized.

Mr. Sangare made the following statement:

I should like to begin by expressing the appreciation of my authorities for the staff papers which explain in a clear and concise manner recent economic and financial developments in The Gambia. The Gambian authorities attached a lot of importance to the discussions leading to this report, as they were taking place at a time when considerations of a medium-term adjustment program were already under way. They are hopeful, therefore, that the conclusion of the 1983 Article IV consultation will pave the way for substantive discussions leading to agreement on a Fund-supported program.

Directors will recall that on February 22, 1982, approval was given to a one-year stand-by arrangement in support of a stabilization program that had been adopted by the Gambian authorities. The program was framed within the context of the authorities' efforts to restructure and diversify the economic base and reduce internal and external imbalances. At that time, the authorities were hopeful that a strong foundation could be built that could facilitate the implementation of a medium-term adjustment program.

Directors were able to review performance under the stand-by arrangement on November 24, 1982, and were generally encouraged by the success that had been achieved thus far. It was noted then that, apart from meeting almost all the quantitative performance criteria, impressive effort had been made in stimulating growth and reducing inflationary pressures. The authorities have since completed the program and it should be noted that all performance criteria covering the remainder of the program period were met despite the persistence of an adverse external environment that has been characterized by depressed export prices of groundnuts, The Gambia's principal export commodity. In this connection, it is pertinent to point out the severity of the deterioration in The Gambia's terms of trade: while there was an increase of about 178 percent in the volume of groundnut exports between 1980/81 and 1982/83, the average export price per metric ton, expressed in terms of the dalasi, decreased from D 1,102.9 in 1980/81 to D 772.0 in 1982/83 despite a depreciation of the domestic currency. Besides, the import price index has been rising by 8-17 percent each year between 1975/76 and 1981/82. No doubt, therefore, The Gambia has continued to be plagued by problems in its external account in spite of the tremendous efforts exerted to correct the situation.

Nevertheless, the general economic outlook in the last two years has been impressive as real GDP expanded by an estimated 10.9 percent and 11.9 percent in 1981/82 and 1982/83, respectively. After declining by an average rate of about 5 percent in the previous two-year period (1979/80-1980/81), this strong recovery reflected mainly the rapid growth of the agricultural sector (29 percent) albeit from a small base. In particular, output of groundnuts rose from 45,000 tons in 1980/81 to 82,000 tons in 1981/82 and 125,000 tons in 1982/83, resulting mainly from improved weather conditions as well as appropriate producer price incentives. Other notable gains were made in manufacturing and reflected, in part, higher volumes of groundnuts available for processing. The tourism industry showed a marked recovery as reflected in the 88 percent increase in air charter tourists. In the meantime, it appears that the authorities have managed to contain inflation.

Some significant progress was also made in the fiscal area as the budgetary deficit was reduced from 13 percent of GDP in 1980/81 to 7.1 percent in 1982/83 reflecting, in part, tax measures taken in fiscal years 1981/82 and 1982/83 which yielded the equivalent of 3.7 percent of GDP and 1.4 percent of GDP, respectively, in additional revenue. Furthermore, as part of the adjustment program, the authorities were successful in putting in place measures that ensured effective control over expenditure so that the budget deficit exclusive of external grants fell from 19.2 percent of GDP in 1981/82 to 9.4 percent in 1982/83, demonstrating substantial effort by the Gambian authorities. As a consequence, recourse to domestic bank borrowing to finance the budget deficit was contained at an average of 0.7 percent of GDP in the two years 1981/82 and 1982/83.

The improvement in the current account of the balance of payments in the last two years has reflected mainly expanded export production as well as significantly reduced import demand resulting from demand management measures taken as part of the adjustment program. The improvement in the current account would have been better were it not for export prices of groundnuts, which remain depressed. With shortfalls in capital inflows in 1982/83, the overall balance of payments position remained under pressure with external reserves being maintained at a precariously low level. As a consequence, The Gambia was forced to incur additional payments arrears.

As Directors observed last November on the occasion of the mid-term review of the stand-by arrangement, the Gambian authorities are also aware that their economy has not "come out of the woods" despite the success achieved in implementing the adjustment program and in stimulating growth. As already noted, the authorities viewed the one-year program as a first stage in their medium-term adjustment efforts which are being undertaken within the framework of the Five-Year Development Plan, 1981/82-1985/86. The objective is to diversify the economy and to reduce the country's dependence on groundnut production. Since the development plan was launched, the authorities have increased outlays for agricultural diversification including the rehabilitation of oil mills. Efforts to mobilize external assistance, which had been decreasing hitherto, are being stepped up while total development outlays are being allocated in line with available resources.

The diversification of the agricultural sector involves the expansion of other cash crops, such as cotton. The potential for fish production is also being exploited with United Nations Development Programme/Food and Agriculture Organization technical assistance and financed by the African Development Bank (AfDB) and Norway. The program also involves the development of livestock. With regard to foodcrops, efforts are continuing to provide, inter alia, extension services, feeder roads, and irrigation facilities. For example, a World Bank-supported Rural Development Program is already under way, while China is helping with an irrigated rice project. Meanwhile, efforts aimed at promoting groundnut production to potential levels are continuing through a project jointly financed by the AfDB and the European Investment Bank. It should be noted in this connection that concurrent efforts to raise producer prices have assisted in raising groundnut production even though this has not translated itself into increased export earnings.

As enunciated in the Five-Year Plan, the strategy in the energy sector is to conserve the use of imported fuels while exploiting alternative domestic energy resources. Accordingly, the authorities are encouraging the use of groundnut shell briquettes as an alternative energy source to charcoal. Pricing of petroleum products continues to reflect the full cost of importation. In the meantime, the authorities are hopeful that a long-term energy strategy can be developed following the completion of a comprehensive survey undertaken with the assistance of the World Bank.

At the time of the staff visit to Banjul, the 1984 budget was still under preparation, but the authorities indicated that efforts aimed at improving revenue collection and tax administration would continue. Furthermore, the machinery for monitoring expenditure that is already in place will be improved upon to ensure better control of government spending. In view of the limited scope for substantial gains in revenues and the overall tight budgetary situation, the authorities feel that continued moderation is necessary.

With regard to state enterprises, a comprehensive study is under way with a view to taking appropriate measures to make them self-supporting. In this connection, the mechanism for monitoring the operations of the parastatals through the National Investment Board was established in line with the schedule set in the stand-by arrangement. To ameliorate the financial problems of the Gambia Produce Marketing Board (GPMB), the subsidy on rice has now been eliminated, while the price of fertilizers was raised by 19 percent in July 1982. It is anticipated that fertilizer prices will be raised by a further 33.3 percent in the fiscal year 1983/84 in accordance with the revised schedule to eliminate these subsidies by 1985/86. In line with the original plan, the increase in bus fares is to coincide with the arrival in The Gambia of the new fleet of buses, which is expected in December 1983. Meanwhile, all other pricing measures included as part of the adjustment program were implemented as planned.

Monetary and credit developments in the last two years have reflected, to a large extent, measures that have been taken in the context of the stabilization program with the overall demand for credit being curbed considerably. This was assisted by the effect of demand management measures already in place, including the increase in interest rates, which are now positive in real terms. The mechanism for monitoring crop credit has functioned satisfactorily as evidenced by the remarkable improvement in the recovery rate, and the World Bank is working with the authorities to further improve smallholder credit facilities.

The immediate prospects for the balance of payments remain difficult in the face of depressed export prices of groundnuts. However, some recovery has been projected for the medium term. The authorities have resisted the use of quantitative restrictions to curb import demand in order to avoid distortions being created in the economy and have relied on the use of fiscal and monetary measures to reduce absorption.

The debt service ratio has been projected to rise from 15.4 percent in 1983/84 to about 20 percent in 1984/85 and will remain at about the same level the following year. My Gambian authorities have expressed willingness to take advantage of the Fund's technical assistance programs in order to improve management of their external debt.

In conclusion, I would like to highlight the main points of this consultation as seen by my authorities:

(1) Positive steps have been taken by the Gambian authorities to adjust domestic demand. These include increased taxes, reduced subsidies on food, increased user charges, tighter expenditure control in government departments, strict monitoring of crop credit, a scaling down of the development plan, and wage and salary restraint. My authorities would like to recall that many of these measures were implemented soon after the 1981 Article IV consultation, well before the stand-by arrangement came into force in February 1982. The measures were reinforced following the implementation of the stand-by arrangement, which ended in February 1983, and have been further strengthened by new fiscal measures introduced in the recent budget.

(2) The worsening external payments arrears problems have been aggravated by external events over which the authorities had no control, such as the decline in aid flows and, more importantly, the decline in groundnut prices. As already indicated, while production returned to normal levels within the last two years, prices declined by more than 30 percent over the same period. Had the groundnut price remained at the 1980/81 level, for example, a substantial proportion of the arrears would have been eliminated.

(3) It is recognized that the GPMB's financial situation has been aggravated by fertilizer subsidies and operating inefficiencies. The Government has responded by a policy decision to phase out the subsidies over a three-year period, faster than recommended by the staff, and by having a consultant to assist the GPMB improve its efficiency. While these positive steps cannot be overlooked, it should also be recognized that GPMB's financial difficulties have also resulted in paying higher producer prices to stimulate output, an action encouraged by the World Bank and the Fund.

Finally, I should like to thank the staff once again for responding to the invitation by my Gambian authorities to commence discussions on a possible use of Fund resources. If The Gambia's development effort is not to be eroded further, my authorities would prefer that the adjustment measures which they have adopted should be supported by an extended arrangement.

Mr. Taylor remarked that, since The Gambia had made clear its intention to implement an adjustment program for which further Fund support would be requested, it would be useful to comment on the elements that ought to be covered in such a program. The momentum of improved financial performance achieved in 1981 had not been sustained in 1982 despite the authorities' commendable performance under the stand-by arrangement, mainly because of a large deterioration in The Gambia's terms of trade, counteracting the increased earnings potential of the groundnut sector. That outcome pointed to the urgent need for diversification of the economy, as the authorities recognized. In particular, the development of rice production might be possible, and an expanded role for the private sector could be encouraged. The revival of the tourist sector was welcome; the foreign exchange benefits likely to arise in that sector should not conceal the need for new investment in tourist facilities.

On fiscal policy, Mr. Taylor observed that the staff had correctly pointed out that action was needed on the expenditure side to encourage development of the productive sectors of the economy. Action was also needed on revenue, although the scope was a little more limited. The move to improve the collection of receipts was important, but it was doubtful whether a better fiscal position would be attained in 1983 unless such efforts were intensified. He hoped that the information provided by the staff at the beginning of the meeting represented mainly a temporary development, and that the economy would soon return to a more satisfactory path.

There were clearly major financial problems in the parastatal sector, Mr. Taylor continued, and priority had to be given to improving the efficiency of the GPMB; its fertilizer subsidies represented a problem. The original plan to phase out subsidies seemed to have been put back one year, a regrettable development that underlined the need for more flexible producer pricing in the sector covered by the GPMB and for further efforts to improve cost effectiveness. Mr. Sangare had stated that the authorities had firmly decided to phase out subsidies within a three-year period, which was welcome evidence of their intention to move in the right direction. They should be encouraged to accelerate the process if possible.

Despite the determined pursuit of tighter financial policies in association with advice from the Fund, Mr. Taylor commented, the balance of payments remained a major cause for concern. Although the current account deficit had been improving, arrears had increased again in 1982, and reserves were declining. Re-exports seemed to be an important element in trade, and it would be desirable to bring that trade more substantially within the customs authorities' net. He invited the staff to provide further information on the plans to improve customs procedures that had been mentioned in the course of the Executive Board's discussion of November 24, 1982 (EBM/82/152).

The discussion of exchange rate policy in SM/83/165 had been brief, Mr. Taylor considered. His chair had suggested that the exchange rate strategy should be examined carefully to assess whether it was the best possible. Was the staff broadly content with the level of the dalasi, and did it support the strategy of pegging the dalasi to sterling, bearing in mind that such an approach would deny the exchange rate a more active role in assisting demand management policy? It was disquieting that concessional inflows and STABEX receipts had been lower than expected in 1982. He invited the staff to comment on the prospects for an improved outcome in 1983. He understood that, despite the recession, the STABEX scheme ought to be able to meet present demands on it, and he wondered whether there were particular problems in The Gambia's case.

The further deterioration of the debt situation, despite the fairly successful implementation of the stand-by program in 1982, was also disquieting, Mr. Taylor commented. The deterioration would have to be arrested and reversed, painful though such action might be in the short run. An improvement in concessional inflows would be an important corrective element. Perhaps a degree of orderly debt rescheduling might be included. At any rate, the authorities had to set themselves clear objectives for dealing with arrears, with the aim of eliminating them reasonably soon. The authorities also had to set themselves a clear objective for rebuilding reserves in the medium term. Incorporation of a definite timetable with regard to arrears and reserve accumulation would be an important item in any new arrangement with the Fund. The staff correctly emphasized that the authorities would need to do their utmost to avoid short-term borrowing and to continue to monitor the debt situation extremely closely. He would certainly support any request for technical assistance in that area that the authorities might make. Such assistance would be an appropriate use of the Central Banking Department's enhanced capabilities in the external debt field.

The form of arrangement that would probably best suit The Gambia's need would be a further one-year stand-by arrangement, Mr. Taylor suggested. Structural adjustment was clearly needed, but it could be incorporated into such an arrangement. Because of the continuing deficiencies in the system of economic information it was difficult to conceive of a multiyear program, particularly given the heavy reliance on unpredictable concessional inflows that made it difficult to plan more than about 12 months ahead. He supported continued cooperation with the Fund, and The Gambia should feel able to count on firm support from the Fund as long as it continued to deal with the difficult external situation.

Miss Diallo observed that The Gambia had been experiencing serious economic difficulties that were structural in nature and known to the Executive Board from the time of the approval of the stand-by arrangement with the Fund in February 1982. The performance under that program had been satisfactory. Indeed, the authorities had been able to achieve the program targets and to meet all performance criteria. The budgetary situation had improved significantly. The deficit had been reduced by almost 6 percentage points in terms of GDP between FY 1980/81 and FY 1981/82 as a result of the new tax measures and further tightening of expenditure control, among other actions.

The current account position had also improved considerably, Miss Diallo noted, a reflection of the gains realized in containing total demand under the Fund-supported program. The increase in the overall balance of payments deficit from 4.5 percent of GDP in FY 1980/81 to

7.3 percent of GDP in FY 1981/82 was largely due to a sharp drop in foreign capital inflows, as well as to the redemption of arrears. It was important to underline the fact that the Gambian authorities had been able to carry out the stabilization effort successfully despite the unfavorable external environment, namely, the world recession with its negative impact on the demand for The Gambia's exports, and the further deterioration in the country's terms of trade. That satisfactory performance in the face of adverse factors was a clear indication of the determination of the country to correct its external and internal economic and financial imbalances. Consequently, the authorities should be commended for their willingness to adopt the approach suggested by the Fund. She invited the staff to comment on the authorities' medium-term development strategy and on their possible request for an extended arrangement.

Mr. Zhang remarked that the staff had referred in its appraisal to an import substitution program. What were the elements of that program, and what were the economic and financial policies that the authorities would have to realign to achieve the program's goal? Would such policies be in conflict with other policies that the Fund supported through the use of Fund resources?

Mr. Suraisry said that the Gambian authorities should be commended for the progress that they had made in reducing the imbalances in the economy over the previous two years. Economic growth had been strong. Inflation had been kept under control, and both the fiscal and current account positions had improved significantly. Those impressive achievements could be traced in part to favorable weather conditions and, equally important, to the effective implementation of the recent stabilization program supported by the Fund. However, it was clear that difficult problems persisted. The overall fiscal deficit remained large in relation to GDP. New arrears had accumulated. More fundamentally, the economy remained heavily dependent on groundnut production, which was subject to changes in weather and world market prices, and progress had been hampered by the lack of foreign exchange. Further efforts were required on both the demand and supply sides; he welcomed the authorities' intention to seek a new arrangement with the Fund.

The main priority was the need to restructure the economy, Mr. Suraisry considered. The second Five-Year Development Plan provided an appropriate framework, and he hoped that the authorities would press ahead with measures to increase the production of new crops, to expand the fishery and livestock sectors, and to promote the tourist industry, in which the results to date had been encouraging. The constraints on external financing underlined the importance of measures to mobilize domestic savings and of early action to improve the fiscal position of the Gambia Produce Marketing Board. In the short term, continued fiscal restraint was essential. Although the scope for further tax increases was limited, he encouraged the authorities to maintain the progress made in strengthening tax administration and expenditure control procedures. The firm policy in public sector wages was commendable, and the proposals to monitor the parastatal enterprises more closely through the National Investment Board were an important step in the right direction.

On the monetary side, Mr. Suraisry continued, the new system for extending and monitoring crop credits had worked well and it should be continued. The large increase in domestic bank financing of the budget deficit in 1983 was potentially worrying, as it could add to inflationary pressures; he hoped that the authorities would explore alternative sources of noninflationary financing. Externally, the overall position was likely to remain difficult unless new aid or commercial loans could be obtained. The early elimination of arrears would be an important means of reducing the deficit and of strengthening The Gambia's creditworthiness. The debt burden appeared manageable at present, but it would need to be watched closely. He fully supported the decision to request technical assistance from the Fund to improve statistics and monitoring in the debt area.

The authorities made a good case for regarding the exchange rate as "an instrument of last resort," Mr. Suraisry added, particularly given the recent depreciation of the dalasi in real effective terms. However, it would be prudent to keep that policy under review. In the case of The Gambia and other countries that pegged their exchange rates to a single major currency, it might be advisable to consider other options. A pegging policy was understandable when the majority of the country's export receipts were denominated in the major currency, but where that was not so, pegging to a basket of currencies, such as the SDR, could help to isolate the country from the effects of fluctuations in major currencies. If the pound sterling were to appreciate significantly in the coming 12 months, it would probably not be in The Gambia's best interest. He invited the staff to comment on that issue.

Mr. de Maulde observed that the economic and financial performance of The Gambia remained highly constrained by its dependence on a single commodity, groundnuts. Recent economic developments, which, according to the staff, were encouraging on the real side of the economy but disappointing on the financial side, were closely related to the development of the production and exports of that commodity. On the real side, the sizable increase in the output of groundnuts for the previous two years appeared to be the main reason for the impressive rate of growth of GDP recorded in the same period. That increase was probably more the result of good weather conditions than of producer pricing policy, since producer prices for groundnuts had been increased by only 4 percent between 1980 and 1983; with an inflation rate of 7.9 percent, prices had decreased by 3.9 percent in real terms. It was possible, however, that the increase in production was the result of a statistical bias, because that part of production that was marketed through official channels could be measured, but not the share of production that went, unofficially, through neighboring Senegal. Nevertheless, the increase in growth, as well as the progress made in reducing the budget deficit and in improving the control of credit, were all achievements for which the authorities should be commended.

With regard to external policy, Mr. de Maulde remarked that the statistical base was not very reliable. However, the increase in external payments arrears clearly showed that the balance of payments situation remained difficult, primarily as a result of the depressed international price for groundnuts. On the occasion of the Executive Board's review of the stand-by arrangement in November 1982, he had doubted that exports could be expected to increase by 30.8 percent between 1980 and 1983, as forecast by the staff, because the increase implied that the terms of trade would improve by more than 21 percent. Unfortunately, the staff had proven to be overoptimistic; there had been no improvement at all in the terms of trade, and exports had increased by only 11 percent. Recently the international price of groundnuts had begun to rise. He hoped that that trend would continue and that it would bring about the much-needed improvement in The Gambia's terms of trade. External payments arrears had been increasing since November 1982, but, suprisingly, no performance criteria under the recent stand-by arrangement had been breached in the last nine months of the program.

The adjustment efforts that had been begun under the stand-by arrangement would have to be continued in the years to come, Mr. de Maulde suggested, and, in that regard, it would be in the interest of The Gambia to enter into a new arrangement with the Fund at an early date. He regretted that it had not been possible to negotiate such an arrangement so far; he welcomed the announcement that a staff mission would be discussing the issue with the authorities shortly. Since The Gambia's main problems were structural--the need to diversify the economy and to reduce its dependence on groundnut production--an extended arrangement, rather than a one-year stand-by arrangement, might well be justified to support the authorities' efforts to implement a medium-term supply-oriented program.

Mr. Erb said that the authorities should be commended for their efforts to implement the adjustment program under the previous one-year stand-by arrangement. Although there was cause for concern in several areas, particularly in light of the staff's information at the beginning of the meeting with regard to the larger than expected credit flows, performance under the arrangement could be regarded as broadly satisfactory. For the future, the most immediate need was to align economic and financial policies, to restructure export earnings, and to promote import substitution. In that regard The Gambia had a longer-term need for financing for the structural effort. He welcomed the active involvement of the World Bank in financing investments related to structural change. The Fund could be especially helpful through the analysis and assistance that it provided in the course of the Article IV consultation missions and through the provision of technical assistance. The Fund could also play a role in encouraging multilateral donors to offer assistance by providing information on macroeconomic policies and trends, including the exchange rate, pricing policy, and fiscal and monetary policies.

With regard to the use of Fund resources, Mr. Erb continued, if Fund financial resources were to be provided in the current circumstances, they should be provided in the context of a stand-by arrangement. He noted the low and volatile level of The Gambia's reserves. In a future program, more attention would need to be paid to rebuilding them. He agreed with

Mr. Taylor's comment that the authorities had to deal with arrears, and with other Directors' comments that the staff should pay more attention to the exchange rate and to exchange arrangements.

The Acting Chairman asked the staff whether it had any information on the current status of Sene-Gambia. Given the propinquity of the economies of The Gambia and Senegal, with a long common border, did the Gambian authorities take into account the price of groundnuts in Senegal when determining groundnut prices for their own producers?

The staff representative from the African Department replied that some of the political institutions of the Sene-Gambia Confederation had already been set up, for example, the Sene-Gambia Parliament, and arrangements were under way in the area of security. However, the staff understood that discussions were still at a preliminary stage on the kind of economic and financial arrangements that the two authorities might agree upon.

With regard to the question of producer pricing policies, the staff representative continued, producer prices in The Gambia had declined in real terms in the past few years, as Mr. de Maulde had pointed out, but prices for groundnuts were higher in both nominal and real terms in The Gambia than in Senegal. As a result, the movement of groundnuts tended to be from Senegal to The Gambia, not the other way around. More important, effective producer prices in Senegal had been reduced recently through adjustments in fertilizer subsidies.

As far as fertilizer subsidies in The Gambia were concerned, the staff representative added, the authorities had sought to phase them out by FY 1984/85, and on that schedule the phasing out would have begun with a 25 percent reduction in FY 1982/83. However, the authorities believed that the schedule should be flexible, and they were seeking to postpone the elimination of subsidies to FY 1985/86, but to increase the size of the reduction to 33 percent--instead of 25 percent)--in light of the financial position of the Marketing Board and the situation in groundnut markets in the period ahead. It was worth noting that the World Bank had requested the authorities to phase out the subsidies over a longer period in view of the projects that the Bank was implementing in the agricultural sector. Thus, it could be argued that the authorities were seeking a middle ground between the views of the Bank and those of the Fund staff, which would have preferred that the phaseout should be completed in FY 1984/85.

There were a number of ways in which the authorities could increase the flow of receipts from exports into the banking system, the staff representative remarked. One suggestion had been a bonded warehouse scheme, but the authorities had believed that the idea needed further study because of the fiscal complexities. The staff intended to take up the question with the authorities during the forthcoming mission.

Commenting on the exchange rate, the staff representative noted that the dalasi had depreciated by 36 percent against the SDR and by 61 percent against the U.S. dollar between 1980 and the end of March 1983, and that, since 1978, the import-weighted effective exchange rate had been depreciating at an annual average rate of 1.3 percent. The most recent information indicated that in the year to July 1983 the dalasi had depreciated by 13.9 percent. At the time of the Article IV consultation in 1981, the authorities had taken the position that it would be unwise to act precipitously, and it could be argued that, in light of recent movements of the dalasi against the U.S. dollar and against the SDR, their caution had been justified. The authorities appeared to be satisfied with the recent downward movement of the currency, which they would have sought even if they had used a different kind of pegging system. The staff would discuss the appropriateness of the present rate with the authorities in the following week.

In doing so, the staff would bear in mind the role that the exchange rate might play in helping to deal with the large deficits faced by the Marketing Board, the staff representative added. It should also be noted that groundnut prices had recovered in the past year; for example, the price of groundnut oil had increased by about 57 percent between August 1982 and August 1983, and the price of groundnut cakes had increased by 36 percent. The authorities would also be looking at other means of improving the efficiency of the Marketing Board, including its cost structure, on the basis of technical assistance from the United Nations. The authorities would also probably wish to take into account the relationship of producer prices in The Gambia to those in Senegal. They appeared to be open to the possibility of an exchange rate adjustment if it could be shown that such an action would be the most effective way of attaining their various objectives with regard to the financial position of the Marketing Board, the remuneration of producers, and the balance of payments.

The shortfall in STABEX receipts did not appear to arise from a particular problem with regard to The Gambia, the staff representative went on, but, at least in part, because some of the countries in the European Community had not been able to meet their commitments. The staff was conscious of the problem of arrears and of external debt in general. The authorities had requested Fund assistance in that area and a member of the Central Banking Department would accompany the forthcoming staff mission. The staff would also discuss with the authorities the comments that had been made on the need to rebuild reserves.

The main area of import substitution on which the authorities were focusing was rice production, the staff representative from the African Department stated. The authorities were looking at a range of policies to promote import substitution, none of which, it appeared, conflicted with the Fund's policies. They were also looking at ways of diversifying exports, through adjustments in producer pricing policy and through the promotion of small manufacturing industry, for example, through the adoption of an investment code. The authorities had indicated very strongly that they did not intend to impose quantitative controls on imports. Finally, the fact that the performance criteria had not been breached, despite recent credit developments, arose, in part, from the fact that the one-year stand-by arrangement had not been couched in fiscal year terms, but in calendar year terms, and that it had covered the period February 1982 to February 1983; during that period all the performance criteria had been met, as noted in SM/83/165.

Mr. Sangare said that Directors had raised a number of interesting questions with regard to the need to improve public finances, to deal with external arrears, and to improve the statistical and economic information base. As Directors had noted, The Gambia's main economic problem was that the economy depended overwhelmingly on one product--groundnuts. Thus, the need was for medium-term solutions to the structural problems. The adjustment program that the authorities were putting in place in the context of the Five-Year Development Plan appeared to be appropriate in that regard. Efforts to improve the financial situation without seeking the diversification of the economy would probably result in failure. Thus, further Fund financial assistance in the form of an extended arrangement would be useful; he could not agree with Mr. Taylor or Mr. Erb that a one-year stand-by arrangement would be appropriate. The Gambia's structural problems demanded medium-term adjustment.

Although the authorities had been able to take a number of domestic measures to deal with their problems, Mr. Sangare continued, the deterioration of the external position had been beyond their control. They had not, therefore, been able to reduce external arrears as much as they would have wished. However, as the staff representative had pointed out, the authorities intended to reduce arrears in the future as the foreign exchange situation improved. He agreed with the points that the staff representative had made on exchange rate policy. While the authorities were keeping an open mind on the question, they did not believe that it was an urgent issue at present. His Gambian authorities had made considerable efforts to meet all the targets and performance criteria of the previous stand-by arrangement and, in doing so, to improve the economic situation of the country. However, the economy remained structurally weak as it depended heavily on groundnuts. Being a small and open economy, The Gambia was susceptible to adverse external developments. For those reasons the Fund should come forth to assist the authorities in their efforts to achieve sustainable growth in the medium term, perhaps within the framework of an extended arrangement.

Mr. Erb said that in commenting on the exchange rate he had not wished to take a position on its appropriateness at present. His point had been that it was difficult to make an adequate assessment of exchange rate policy on the basis of the information in the staff papers; nor was it clear what the authorities had in mind by their statement that exchange rate adjustment was an instrument "of last resort." He looked forward to a more detailed discussion of the criteria that the authorities used in assessing the appropriateness of the rate and of the impact of the various exchange controls on the economy.

Mr. Suraisry stated that in his remarks on pegging the dalasi to a basket of currencies he had not intended to imply that the authorities should act urgently on the exchange rate issue. Indeed, as he had said, he agreed with the authorities' intention to use the exchange rate as an instrument of last resort.

Mr. de Maulde inquired whether the World Bank would participate in the forthcoming staff mission to The Gambia.

The staff representative from the African Department replied that the World Bank had been invited to participate in the mission, but, because of staffing considerations at present, it would be unable to do so. However, the Fund staff had received a World Bank appraisal of The Gambia's investment plan, and the Bank staff had agreed to comment further on the plan in the light of new information provided in the course of the Fund staff's mission.

The Acting Chairman made the following summing up:

> Directors agreed with the thrust of the views expressed in the staff appraisal. They noted that, despite the recovery in real GDP in the previous two years, the Gambian economic and financial situation remained difficult, especially since early 1983, partly as a result of The Gambia's worsened terms of trade; some of the encouraging gains that had been made in the recent program with the Fund were being eroded on account of expansionary fiscal and credit policies.
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> Directors stressed the need for continued determination by the authorities in implementing adjustment policies. In that context, they welcomed the authorities' intention to seek Fund support for a comprehensive program of adjustment and they stressed the need for a tighter budgetary and credit policy, continued wage restraint, realistic pricing policies, and measures to improve the financial performance of public enterprises such as the Produce Marketing Board. On the fiscal front, Directors emphasized the importance of strict expenditure control in light of the very limited room for discretionary revenue gains. They also believed that special attention should be given to measures to restructure the productive base, to encourage private sector activity, including tourism, and to promote exports.
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> Directors regretted that the progress made in reducing external arrears had recently been reversed and they urged the authorities to make intensified efforts to eliminate the restrictive practice emanating from arrears. Concern was expressed about the rising external debt burden and the low level of reserves, and it was suggested that exchange rate policy should be carefully reviewed. The Fund could usefully make technical

assistance available in various areas, including debt monitoring, in order to support the determined efforts of the authorities to correct the existing disequilibrium.

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

The Executive Board then took the following decision:

Decision Concluding 1983 Article XIV Consultation

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

2. The Gambia's exchange system involves payments arrears, as described in SM/83/185, which are subject to approval under Article VIII. The Fund urges the authorities to eliminate this restriction as soon as possible.

Decision No. 7504-(83/123), adopted
August 26, 1983

3. TUNISIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Tunisia, together with a proposed decision concluding the 1983 Article XIV consultation (SM/83/100, 5/25/83). They also had before them a report on recent economic developments in Tunisia (SM/83/118, 6/8/83).

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

The following information on developments during the first half of 1983 has become available to the staff subsequent to the issuance of the consultation reports SM/83/100 and SM/83/118.

In late June, the Minister of Planning and Finance (Mr. M. Moalla) was replaced as Minister of Finance (by Mr. S. M'barka) and as Minister of Planning (by Mr. I. Khelil). The staff has been in contact with Tunisian officials but has not been informed of any new remedial measures in the fiscal and monetary areas.

With regard to domestic financial developments, over the first quarter of 1983 there was an increase in banking system credit to the economy (the private and nongovernment public sectors) of 4 percent, which brought the increase for the year ended March to 23 percent. The increase in the January-March period was accommodated entirely by additional bank recourse to the Central Bank. Over the 12-month period ended March 1983, net claims on Government rose by 39 percent, domestic credit by 25 percent, and broad money by 15 percent.

Reflecting partly the halt in the price liberalization process, during the first five months of 1983 the official consumer price index was essentially unchanged.

It now appears that the overall balance of payments deficit in 1983 may be substantially larger than indicated in the consultation reports (SDR 30 million). Over the first half of the year, Tunisia's gross official international reserves declined by SDR 223 million (or 40 percent), to SDR 333 million (equivalent to 1.4 months of projected 1983 imports). During the first four months of 1983, the trade deficit was about SDR 100 million larger than during the comparable period in 1982. The value of exports (in terms of SDRs) was about 26 percent below the January-April 1982 level, attributable to a drop of 56 percent in petroleum exports, reflecting largely a fall in volume (47 percent). Imports through April were some 6 percent below the level of the corresponding period in 1982.

The Tunisian dinar has continued to decline vis-à-vis the SDR. During the period January-June 1983, the decline was 6.7 percent, bringing the decrease for the 12-month period ended June to 9.1 percent.

Mr. Salehkhou made the following statement:

My Tunisian authorities would like to thank the Fund mission for its efforts to present Tunisia's economic situation and prospects in a concise and professional manner. While the staff appraisal and recommendations call for a number of remarks on the part of Tunisia, differences should be regarded mainly as matters of emphases and priorities.

In 1982, Tunisia's economic performance was generally less satisfactory than in previous years. In the 1970s, Tunisia experienced a strong economic performance, mainly due to the authorities' cautious management and financial policies. The economy had benefited from an impressive improvement in the terms of trade, which was partly the result of higher prices for oil and, to a lesser extent, for phosphates. These policies were designed to generate higher domestic savings and promote investments while preventing an overheating of the economy. Hydrocarbon revenues were expected to decline in the medium term, thus transforming the country into a net oil importer. Tunisia's investment effort, therefore, was directed toward changing the structure of the economy, mainly through industrial diversification and development of the agricultural sector. Prior to 1982, Tunisia succeeded in maintaining a very high ratio of investment to GDP, in addition to substantially increasing the real income per capita--despite a high rate of growth in population--and significantly lowering the resource gap.

Similar policies and development strategy are projected for the Sixth Development Plan (1982-86), which aims mainly at the continuation of economic expansion and strengthening of industrial diversification despite a lower ratio of investment to GDP. However, performance was rather disappointing during the first two years of the plan, with a low rate of real growth, higher inflationary pressures, and imbalances in the fiscal and external accounts.

The new deteriorating trend in the economy was largely attributable to the adverse impact of exogenous factors and, to a lesser extent, to the expansion of domestic demand. Adverse exogenous developments included in the main (a) a severe drought, which affected agricultural areas in particular; (b) the international economic recession, which resulted in sharp declines in exports and tourism receipts; and (c) a considerable deterioration in Tunisia's terms of trade, which reversed the favorable trend of the last decade.

The Tunisian authorities share the staff's view that the present economic situation is difficult and a matter for concern. They also basically concur with the thrust of the staff analysis with respect to the medium-term adjustment that is required to restore economic growth and correct external and domestic imbalances. However, they feel that the staff report does not seem to take sufficient account of the country's overall realities and its economic and sociopolitical constraints. They further believe that the report does not emphasize the efforts being made by Tunisia to cope with the economic deterioration and, at the same time, avoid jeopardizing the country's development plans.

In this regard, it is important to note that most of the adjustment measures proposed by the staff mission are contained in official Tunisian documents such as the Economic Budget and the Sixth Development Plan. The authorities feel, however, that such measures could only be introduced gradually in light of the country's real constraints and order of priorities. For example, the authorities are aware of the need to reduce and eliminate subsidies granted to public enterprises, as suggested by the staff. Nevertheless, in view of structural factors--depletion of mineral resources and overstaffing--and of the impact of price increases on the Government's policy to contain wages, they intend to implement such reduction only gradually. Furthermore, the authorities are apprehensive that an abrupt phasing out of subsidies would lead to the closure of the enterprises concerned, thus resulting in undesirable socioeconomic consequences.

Similarly, for the medium term, the authorities are convinced that a limitation of nonessential imports through administrative measures, combined with appropriate monetary and credit policies, is the best course of action for containing the current account deficit of the balance of payments within the limits of Tunisia's capacity for indebtedness.

Regarding the Government's policy to generate further employment by favoring more labor-intensive industries, the staff report suggests that this requires a change in the relative cost of capital and labor, which thus far has encouraged use of capital. As this approach implies a rise in interest rates, the authorities believe that it is hardly conceivable at present, given its adverse effects on the competitiveness of enterprises and the promotion of investment. In this connection, they feel that the policy objective could be attained by measures designed to encourage employment, particularly through tax incentives.

With regard to interest rate policy in general, the staff report's indication that the authorities will effect an upward revision of the structure of interest rates on deposits--in order to harmonize them with the yield of up to 10.4 percent a year envisaged for zero coupon government bonds--calls for some observations.

First, although an obligatory loan was indeed foreseen during the consultations, the terms and arrangements for such an issue were by no means definitive. Those mentioned in the report were, in fact, nothing more than working assumptions subject to reconsideration at the time of issue.

Second, the country's position should be interpreted as a determination to mobilize private savings, to help limit the rate of growth of consumption, and to stimulate the recycling of part of the wage increases through a diversification of savings schemes that would satisfy the real motivations of savers. The success of these schemes--which, again, will be introduced gradually when circumstances permit--is, nevertheless, dependent on the extent to which they meet the needs of savers. Thus, there is no obvious link between the review of the general structure of interest rates on savings and the yield on the obligatory loan, principally because this loan constitutes a one-time, special measure.

In conclusion, the Tunisian authorities are committed to pursue their traditionally pragmatic and prudent economic and financial policies. Recognizing that the economic environment of the first two years of the Sixth Development Plan has proved to be less favorable than envisaged, they intend to review and update the plan targets in the light of recent adverse economic developments and of the report on the 1984 Economic Budget, which is in preparation. It is possible that Fund technical assistance will be sought with respect to the envisaged economic program covering the period remaining under the Sixth Development Plan.

Extending his remarks, Mr. Salehkhou stated that the imbalances in Tunisia's financial management outlined in SM/83/100 were based on provisional information for 1982 and preliminary estimates for 1983, which would have to be finalized in light of the actual results for those two years, with particular attention being given to the changes introduced by the Supplementary Budget. For example, according to more recent information, the deficit in the government budget for 1983 would amount to 5.9 percent of GDP, rather than the expected 6.6 percent referred to on page 9 of SM/83/100. Similarly, the increase in domestic prices in 1983 was expected to be less than 10 percent in relation to the average level for 1982, rather than the 11 percent referred to on page 5 of the same document. Furthermore, in the first four months of 1983, there had been a decrease in household consumer prices estimated at 0.3 percent, in contrast to an increase of 2.3 percent in 1982.

Mr. de Maulde remarked that his first impression on reading the staff papers and on hearing Mr. Salehkhou's statement was that Tunisia's economy remained basically sound and well diversified, with a potential for above average growth, thanks to an imaginative and well-managed system of planning and public investment policy. His second impression, reinforced by the most recent information provided by the staff, was that, in the period since the previous Article IV consultation, Tunisia had entered a dangerous period of disequilibrium, as evidenced by the heavy loss of official reserves in the previous few months. A number of causes for the present situation were exogenous, but other factors were of Tunisia's own making, in particular, insufficiently firm fiscal and monetary policies and a wage policy inconsistent with the maintenance of an appropriate level of relative prices.

There was basic agreement between the staff and the Tunisian authorities on the need to implement adjustment policies, Mr. de Maulde continued, and on what those policies should be: first, to reduce the public sector deficit through restraints on expenditure, because there did not appear to be much room to increase tax revenues; second, to adopt a restrictive monetary policy; and third, to contain the wage drift of the previous few months. There was less agreement on the pace of implementation of such an adjustment policy. Mr. Salehkhou believed that the necessary measures could only be introduced gradually in light of the country's constraints and priorities. Naturally, it was difficult for outside observers to give advice because they might not be able fully to appreciate all the subjective factors alluded to by Mr. Salehkhou in terms of the economic, political, and social realities. Nevertheless, the common experience of many member countries was that adjustment was all the more difficult and painful the longer that it was delayed, and that realism could also pay political dividends. He invited the staff or Mr. Salehkhou to comment further on the current intentions of the authorities with regard to wage policies and import restrictions.

Mr. Mtei observed that until recently Tunisia had enjoyed relatively strong economic growth under fairly stable internal and external conditions, reflecting good terms of trade and sound and pragmatic economic management policies. The authorities should be commended for their performance in that regard. Of late, however, signs of strain had developed. The emergence of somewhat unstable financial conditions had prompted the Tunisian authorities to embark on a restructuring program in the context of their Sixth Development Plan. The general strategy embodied in the plan was appropriate and the quantitative targets were reasonable and achievable, allowing for the inevitable margin of error in such projections. For example, the growth target was broadly in line with the average growth rate attained over the five-year period ended in 1981, and it was not significantly different from the staff's projection of 5 percent growth. He was concerned, however, that the staff recommended a cutback in the capital budget in order to achieve further fiscal adjustment. Such an approach would have implications for the growth rate, and a reduction in development outlays might jeopardize the desired diversification of the economy. He invited the staff to comment further on the question, and, in particular to say whether the plan contained elements that could be postponed without undue implications for future growth.

He agreed with the staff that there was a need for moderation in wage increases, Mr. Mtei went on, as well as a need to reduce, and, if possible, to eliminate subsidies and transfers to public enterprises. The authorities would be well advised to heed the staff's advice that success in moving Tunisia's industry onto a more labor-intensive path would depend crucially on success in restraining wage costs. The staff also proposed that the authorities should "curb current and capital transfers to Tunisia's vast system of nonfinancial public enterprises" in order to improve the financial position of the Government. While such a policy might have an immediate impact on the budget, the position of the authorities deserved to be emphasized, namely, that it would be better to improve the operations of those entities in order to reduce progressively their need for budgetary support. He welcomed the measures taken to monitor the activities of the corporations and to identify a limited number of enterprises that could remain under government control. He hoped that the exercise would help to rationalize the public sector enterprises in the medium term.

Commenting on monetary policy, Mr. Mtei said that he understood the concern expressed by the staff that the increase in lending operations by the development banks might increase liquidity and create additional strains on both domestic prices and the balance of payments. He hoped that such adverse consequences could be minimized if, as the authorities contended, such credit was used to expand the productive base. He also shared the concerns expressed by the staff with regard to the long-term balance of payments prospects, particularly when the current account deficit implied a need for higher levels of external financing on commercial terms, which could exacerbate the debt service burden. Finally, if rigorous implementation of a strong adjustment effort implied a review of the Sixth Development Plan, such a review should be undertaken in a manner that did not jeopardize the original objectives of the plan.

Mr. Williams commented that the recognition by the Tunisian authorities of the present difficult circumstances was welcome. He noted their commitment to continue pursuing pragmatic and prudent financial policies. Nevertheless, there was an urgent need for the authorities to come to grips with the challenges confronting the Tunisian economy. Developments in the first half of 1983 had turned out to be much less favorable than hoped for at the time that the staff report had been issued. In the face of continuing deterioration, the preparation of a financial and structural adjustment program for 1984-86 later in the year would take on added importance. The staff appraisal contained a clear, concise set of policy recommendations with which he fully agreed. The conclusions and recommendations contained in the appraisal constituted an appropriate basis for the wide-ranging adjustment effort that the Tunisian economy clearly required at present.

Mr. Suraisry noted that Tunisia had experienced considerable progress for a number of years while maintaining both external and domestic financial stability. Those developments had resulted mainly from the pursuit of prudent policies for which the authorities should be commended. In 1982, however, a number of external and internal developments had led to a deterioration in the economic and financial situation. Agricultural production had declined by 9 percent as a result of a severe drought. Exports had declined by 14 percent because of slackened external demand, and inflationary pressures had been intensified as a result of the granting of substantial wage increases. The authorities had adopted a number of corrective measures to deal with the deteriorating situation, but they had proved to be inadequate, as economic growth had slowed, inflation had intensified, and both the fiscal deficit and the current account deficit had widened significantly.

For 1983, the growth prospects were expected to improve, Mr. Suraisry continued, while the financial situation would remain under strain, as confirmed by the most recent information provided by the staff. Those developments indicated the need for the authorities to pursue firm adjustment policies aimed at reducing the fiscal deficit, containing monetary expansion, and accomplishing the restructuring measures envisaged in the Sixth Development Plan, including the liberalization of exchange and trade restrictions. In doing so, they would need to keep the original objectives of the plan in view.

The balance of payments and external debt projections indicated that the situation was manageable over the medium term, Mr. Suraisry considered. The balance of payments was projected to record small overall surpluses up to 1986, and the debt service ratio was expected to be maintained at about 17 percent. Those projections were based on the assumption that the authorities would carry on with their policies as envisaged in the Sixth Development Plan. He noted that the authorities intended to seek technical assistance from the Fund for the preparation of a financial and structural adjustment program covering the years 1984-86. He supported that request, and he invited the staff to comment further on the matter. The Tunisian authorities had demonstrated a great ability to overcome their economic problems in the past, and he was confident that they would be able to do so in the future.

Mr. Schneider remarked that, in considering economic developments in Tunisia, it was important to keep in mind that Tunisia had succeeded in achieving high growth rates during the decade from 1971 to 1981, while maintaining domestic financial stability and a strong balance of payments position. That progress had been achieved in spite of limited natural resources, apart from petroleum and phosphates. In 1982, however, the economy had been affected by adverse developments of an exogenous nature--the reduction in world oil prices, the drought that had resulted in a decline in agricultural output, and the weak external demand. But instead of adjusting financial policies to changed circumstances, the authorities had continued with expansionary fiscal and monetary policies, thereby creating for the economy both short-term and medium-term problems that needed to be corrected quickly in order to ward off the emergence of more deep-rooted imbalances. The matter had become all the more important since the additional information provided by the staff indicated that the situation in 1983 would be worse than expected when SM/83/100 had been written. The implication was that to date neither the efforts of the authorities nor the recovery of the agricultural sector would have a positive impact on the economic and financial situation for 1983.

Under the assumption of an average growth rate of 5 percent from 1983 to 1986, Mr. Schneider continued, the staff projected that the current account deficits in those years would continue to be about 8 percent of GDP. That situation underlined the urgent need for structural changes in the economy, as advocated by the staff. One of the major problems was the very high unemployment rate, estimated at 25 percent in 1981 and expected to remain at that level throughout the period of the Sixth Development Plan. It was a rather disappointing feature of the plan, and to deal with the problem the authorities should encourage investments in labor-intensive industries and in the services sector, and should improve and increase the contribution of the agricultural sector. He noted, according to the information provided in SM/83/118, that the authorities were encouraging emigration, especially to the Gulf States. Considering the evident difficulties of such a policy, it would be interesting to have further information on the subject from either Mr. Salehkhou or the staff.

Commenting on fiscal policy, Mr. Schneider said that he understood the authorities' reluctance to consider increases in tax rates. The high tax rates had resulted in total revenues equivalent to 35 percent of GDP, making it necessary to look mainly to the reduction of expenditures and subsidies and to an improvement in the financial position of the public enterprises. The financial position of most of those enterprises had been under pressure and it had deteriorated further in 1982. The commitment and effort of the authorities to improving their position was welcome; it would not only benefit exports, it would also relieve the burden on the budget.

Another problem in the Tunisian economy was that monetary expansion was taking place faster than the growth of nominal GDP, Mr. Schneider remarked. He agreed with the staff that there would be additional liquidity in the economy if development banks extended the expected loans and if the Government borrowed more than was projected at present. It might be advisable, therefore, to increase interest rates, which were negative in real terms at present. Exchange rate policy should continue to aim at maintaining a realistic margin of competitiveness for the Tunisian economy. However, the real effective exchange rate had come under increasing pressure in the past few years as a result of the rapid increase in labor costs. The intention of the authorities to establish an indicator for the real effective rate of exchange on a multilateral basis was welcome. Such a model would help the authorities to monitor the exchange rate more effectively than had hitherto been possible.

He regretted that practically no progress had been made since the previous Article IV consultation with regard to restrictions on payments for current international transactions, Mr. Schneider stated. In that regard, he agreed with the staff that import and price restrictions were not a substitute for needed domestic policy adjustments. Such an observation could be made for almost all countries. Finally, he welcomed the authorities' intention to request Fund technical assistance in the preparation of a technical and financial program covering the period from 1984-86. He hoped that such cooperation would lead to a realistic adjustment program that would take into account the room for maneuver of the Tunisian authorities under the prevailing circumstances.

Mr. Abiad stated that, since the previous Article IV consultation with Tunisia, progress had continued to be made in several important areas. The process of restructuring the productive base of the economy with a view to reducing its dependence on oil was proceeding broadly along the lines envisaged in the new development plan. Adjustment efforts that had been made in 1982 and that aimed at improving the efficiency of resource allocation and at reducing cost-price distortions included sizable increases in agricultural prices, a greater role for market forces in the setting of retail prices, and the pursuit of a pragmatic exchange rate policy. Moreover, steps had been initiated to strengthen the financial position of the public sector enterprises. However, such progress had been accompanied in 1982 by a less favorable economic performance than in previous years. There had been a sharp deceleration in the rate of growth of real GDP, a widening of domestic and external financial imbalances, and a resurgence of inflationary pressures. Those results reflected the impact of several exogenous as well as some domestic factors, including a drought, depressed foreign demand, developments in the world oil market, and a relaxation of financial policies associated in part with the adjustment of wages.

Noting that the authorities shared the staff's concerns about Tunisia's difficult domestic and external economic situation, Mr. Abiad observed that they had clearly signaled their awareness of the need for policy action to correct weaknesses in several areas. As many of the difficulties were related to structural rigidities, the authorities had understandably expressed a preference for a gradual approach to the solution of those problems within an appropriate time scale. A pragmatic implementation of the current development plan could make an important contribution to the adjustment process. The reference by the staff to the downward revision of the forecast for real GDP growth from 1982 to 1986, and the consequent need to lower the target for the growth of consumption in order not to hamper investment unduly, was indicative of the authorities' readiness to adapt their policies to changing economic circumstances, and to adjust the economy to a less advantageous environment. That approach was further confirmed by the authorities' intention to prepare a structural adjustment program with the Fund's technical assistance. He invited the staff to comment further on the nature of such a program and particularly on the scope for its external financing.

The authorities had indicated their intention to limit the current account deficit by directly, but flexibly, containing imports, Mr. Abiad noted. While it was true that import controls were imperfect substitutes for appropriate financial policies, an immediate relaxation of import quotas for consumer goods might be counterproductive in Tunisia's present circumstances, unless greater access for Tunisia's exports to markets of its main trading partners became available at the same time.

The staff representative from the African Department commented that the major difference between the views of the staff and those of the Tunisian authorities concerned the pace of implementation of the various measures. In view of developments in 1982 and in the first half of 1983, the staff had expected some action in the monetary and fiscal areas, and a range of policies in those areas had been suggested in the staff appraisal. The staff understood the constraints facing the Tunisian authorities, but it had not been informed of any action in those areas in recent months.

At the time of the most recent mission to Tunisia, the staff representative continued, negotiations had been under way between the authorities and the trade unions. It had been the authorities' intention to limit the increase in the minimum wage to 12 percent, an amount that they believed would be consistent with limiting the increase in total wages to 16 percent, in line with the increase in nominal GDP. Achieving that goal would represent a substantial improvement compared with the position in 1982, when the increase in the wage bill had been twice that of nominal GDP. The staff was not aware at present of the outcome of the final negotiations, and it expected to be informed of them during the forthcoming Annual Meeting. With regard to the question of administrative restrictions on imports, the staff understood, from information in the press, that those controls had recently been formalized, and that it was intended to restrict industrial imports to 80 percent of the 1982 level.

Whether the cutback in the capital budget recommended by the staff would hurt the development effort in the medium to long term would depend to a great extent on whether such cuts were selectively made and well conceived, the staff representative considered. Otherwise, they could indeed have a detrimental effect on growth. The staff had not looked at the sectoral implications of such cuts; that was a more appropriate area for the World Bank, which had a program with Tunisia and which was considering the issue. The staff had recommended the reductions in capital outlays in 1983 because it was one way in which financial savings, both external and domestic, could be achieved. The Tunisian authorities' request for Fund technical assistance in preparing a financial structural adjustment program covering the period 1984-86 would have to be reconfirmed during the Annual Meeting because there had been a change in the structure of ministries and new ministers had been appointed in Tunisia in recent months.

Mr. Salehkhou noted that the question of interest rate policy had been referred to by some Directors. The Tunisian authorities were aware of the benefits of a harmonized interest rate structure; they intended to review their policy in light of the staff's recommendations and taking into account the motivations of savers. However, interest rates would continue to be used as incentives to encourage the growth in vulnerable sectors, particularly the agricultural sector, the development of which was the major objective of the Sixth Development Plan. Tunisia's potential in agriculture was relatively good, and interest rate incentives had already played a useful role. It would be difficult for the authorities to reduce or to eliminate such an incentive, particularly when their general policy aimed at reducing the exodus from rural areas to the cities. With regard to the question of whether interest rates should be positive in real terms, domestic inflation and international interest rates were not necessarily the best barometers for assessing the appropriateness of interest rates, particularly in the case of Tunisia, where the present level served economic purposes in line with the country's general development strategy. Interest rate policy was not the only instrument used to encourage agricultural production; other measures included increases in producer prices and a flexible exchange rate policy.

With regard to wage policy, Mr. Salehkhou continued, the authorities recognized that the substantial increases experienced in the previous two years were unsustainable and that they needed to be contained. However, those wage increases had occurred in the context of serious social unrest, which they had helped to alleviate. In 1983, the authorities were aiming at tight control of wages, keeping increases to 16 percent, compared with about 30 percent in 1982, while the increase in the minimum wage would be kept down to about 12 percent. The encouragement of labor migration to the Persian Gulf States was regarded as a short-term solution to alleviate the problem of unemployment. Given the position in the world oil markets, and particularly the position of the Persian Gulf States at the moment, the policy was not regarded as a long-term one.

His Tunisian authorities generally agreed with the concerns expressed by Executive Directors with regard to the distorting effects of subsidies on prices, wages, and productivity, Mr. Salehkhou stated. However, they strongly believed that the political and socioeconomic realities needed to be taken into account, particularly with regard to vital consumer goods and to subsidies to public sector enterprises. In recent years, subsidies had been crucial in attenuating social unrest and in ensuring the stability necessary for industrial expansion; they would also play an important role in the implementation of the Government's policy aimed at encouraging more labor-intensive industries.

It was the authorities' firm intention to prevent any recourse to further external financing that would result in a heavier debt service burden, Mr. Salehkhou emphasized, although the debt service ratio was low by international standards. The authorities also intended to continue their flexible exchange rate policy that had led to a steady depreciation of the Tunisian dinar. Furthermore, the authorities were in the process of reviewing the outdated targets of the Sixth Development Plan, and they would adopt a comprehensive economic and financial program aimed at tackling both external and domestic economic imbalances. However, they would continue to prefer import restrictions on unnecessary and luxury consumer goods because the effectiveness of other instruments in containing such imports was questionable.

The Acting Chairman made the following summing up:

> Directors generally concurred with the thrust of the views expressed in the staff appraisal. While recognizing that Tunisia's economic performance and external accounts in 1982 had been adversely affected by exogenous factors, such as drought and weak world demand for major exports, Directors considered that expansionary domestic policies had contributed importantly to the widespread deterioration. In particular, they commented on the large increases in wages and salaries, the rapidly widening fiscal deficit, and the sharp rise in domestic credit.
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> For 1983, Directors noted the projected pickup in economic activity. However, they expressed concern that both the fiscal and external current account deficits were expected to widen further, and they pointed to the adverse developments in those areas to date. Directors observed that the authorities were closely monitoring the exchange rate to ensure against the erosion of Tunisia's competitiveness. They regretted, however,

that additional fiscal and monetary measures had not yet been forthcoming, and stressed that a tightening of restrictions on imports and a halt in the price liberalization process were not appropriate substitutes for demand restraint measures.

Directors welcomed the changes already implemented within the framework of the Sixth Plan to restructure the economy, to boost exports, and to promote agricultural production and a more efficient public enterprise system, and they encouraged the authorities to continue those efforts. Nevertheless, it was generally believed that greater emphasis should urgently be accorded appropriate demand management policies if Tunisia was to maintain a viable balance of payments and debt posture. There was a clear need for firmer incomes, monetary, and fiscal policies. The authorities' views on more gradual adjustment were noted, but Directors generally stressed that delays would seriously risk exacerbating the burden of adjustment.

Directors noted that although the tax reform might ultimately enhance revenue collections, strengthened efforts to contain the growth of expenditures were more immediately required, particularly on personnel, subsidies, and nonessential capital outlays. An appropriate tightening of credit policy and increases in interest rates, which remained negative in real terms, were also advocated. It was also stressed that, as with import restrictions, the authorities should aim at the progressive liberalization of restrictions on payments and transfers for current international transactions.

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

The Executive Board then took the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Tunisia, in the light of the 1983 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. No significant changes have been made in Tunisia's system of exchange restrictions since the last consultation. The Fund encourages the authorities to ease restrictions on payments and transfers for current international transactions.

Decision No. 7505-(83/123), adopted
August 26, 1983

4. ST. CHRISTOPHER AND NEVIS - MEMBERSHIP - COMMITTEE

The Acting Chairman recalled that on August 2, 1983 the Fund received an application for membership from St. Christopher and Nevis (EBD/83/202, 8/3/83). He proposed that a committee should be established to proceed with the formal investigation and report to the Executive Board.

The Executive Board agreed to the proposal by the Chairman and took the following decision:

> A reasonable time for discussion and preliminary investigation having elapsed, under Rule D-1 the Executive Board decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of St. Christopher and Nevis any matters relating to its application for membership in the Fund.
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> The committee shall consist of Mr. Lovato (Chairman), Mr. Donoso, Mr. Hirao, Mr. Joyce, Mr. Salehkhou, Mr. Sangare, and Mr. Wicks.

Adopted August 26, 1983

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/122 (8/24/83) and EBM/83/123 (8/26/83).

5. BAHRAIN - 1983 ARTICLE IV CONSULTATION - POSTPONEMENT

> The Executive Board notes the request contained in EBD/83/219 (8/22/83). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1983 Article IV consultation with Bahrain to not later than September 16, 1983.

Decision No. 7506-(83/123), adopted
August 24, 1983

6. APPROVAL OF MINUTES

> The minutes of Executive Board Meeting 83/52 are approved. (EBD/83/215, 8/18/83)

Adopted August 25, 1983

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/216 (8/23/83) and EBAP/83/217 (8/24/83) and by an Advisor to Executive Director as set forth in EBAP/83/217 (8/24/83) is approved.

APPROVED: February 28, 1984

LEO VAN HOUTVEN
Secretary