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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/142

3:00 p.m., September 16, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	G. Ercel, Temporary
	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	J. C. Williams, Temporary
M. Finaish	T. Alhaimus
	T. Yamashita
	I. R. Panday, Temporary
R. K. Joyce	G. W. K. Pickering, Temporary
	D. I. S. Shaw, Temporary
A. Kafka	H. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	S. El-Khouri, Temporary
	T. de Vries
	M. J. Kooymans, Temporary
	O. Kabbaj
	A. A. Agah, Temporary
F. Sangare	
M. A. Senior	
	A. K. Juusela, Temporary
N. Wicks	C. Taylor
	Shao Z., Temporary

J. W. Lang, Jr., Acting Secretary
L. Collier, Assistant

Also Present

M. Dairi, Division Chief of the Treasury of Morocco. African Department: O. B. Makalou, Deputy Director; M. W. Bell, E. L. Bornemann, E. A. Calamitsis, R. O. Carstens, F. d'A. Collings, S. E. Cronquist, M. E. Edo, A. G. A. Faria, R. Franco, M. G. Gilman, U. R. Gunjal, A. Jbili, J. W. Kratz, M. E. Massourakis, T. Oyama, R. L. Sharer. Asian Department: U. Baumgartner, S. Kimura, A. N. Mansur. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; J. A. Clement, M. Guitian, T. Hatayama, S. Kanesa-Thasan, J. M. T. Paljarvi, C. Puckahtikom. Fiscal Affairs Department: A. M. Abdel-Rahman, W. R. Mahler, A. Tazi. Legal Department: W. E. Holder, Ph. Lachman, A. O. Liuksila, J. M. Ogoola. Middle Eastern Department: A. K. El-Selehdar, Deputy Director; F. Drees, H. E. Jakubiak, E. M. Taha. Western Hemisphere Department: J. Ferrán, J. E. Gonzalez, A. S. Linde, C. J. Lindgren. Bureau of Statistics: J. B. McLenaghan. Advisors to Executive Directors: S. R. Abiad, J. R. N. Almeida, C. J. Batliwalla, T. A. Connors, L. Ionescu, H.-S. Lee, W. Moerke, P. D. Péroz, M. Z. M. Qureshi. Assistants to Executive Directors: H. Alaoui-Abdallaoui, M. Camara, M. B. Chatah, R. J. J. Costa, M. Eran, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, J. M. Jones, H. Kobayashi, J. Schuijer.

1. MOROCCO - STAND-BY ARRANGEMENT

The Executive Directors continued from the previous meeting (EBM/83/141, 9/16/83) their consideration of a request by Morocco for an 18-month stand-by arrangement in an amount equivalent to SDR 300 million (EBS/83/178, 8/19/83).

The Deputy Director of the African Department, responding to questions raised at the previous meeting, said that the financing gap for 1983 was in fact financeable. The overall gap was about SDR 178 million, of which about two thirds would be available, leaving a balance of SDR 75 million-100 million to be financed, which amounted to 1.5-3 percent of export receipts, or less when remittances of Moroccan workers abroad were included. Even in the case of full financing, a margin of error of close to 5 percent was acceptable. In addition, the Board had in the past approved cases where full financing had not been available. The balance of financing that remained uncommitted was acceptable, and the staff believed that the gap would be filled.

Morocco's gross reserves had decreased from approximately SDR 250 million at the beginning of 1983 to SDR 75 million-80 million in mid-June, the Deputy Director went on. An assumption in the program for 1983 was that Morocco would not lose any reserves and that the decline in net foreign assets would equal the use of Fund resources, implying a rebuilding of reserves during the last six months of about SDR 175 million. If necessary, the financing gap of SDR 75 million-100 million could be met by the loss of reserves incurred, resulting in no increase in reserves during the first six months of the program period. For those reasons, the staff was confident that the 1983 gap was financeable. On the other hand, it was difficult to forecast the situation for 1984, and he agreed with several Directors who had stressed the importance of receiving assurances at the end-November review that the gap would be filled.

The staff had weighed various considerations before recommending approval of the program without assurance of the financeability of the gap, the Deputy Director continued. In particular, the commercial banks were aware that Morocco's three Fund programs had not resulted in an improvement in the situation. If the proposed decision on financing were not approved, the commercial banks might misinterpret the nonapproval as a lack of confidence in the program, and so postpone their commitment. The commercial banks had met that day and had reported to the staff their decision to reschedule Morocco's debt; earlier the staff had informed the banks that the Board would not approve the decision at the present meeting unless Executive Directors could be notified that commercial banks would maintain their short-term exposure. The Liaison Committee had met one week after receiving the request from the Moroccan authorities. For those reasons, the staff's approach with regard to the financeability and the proposed decision was justified.

With regard to confidence in the performance criteria, he agreed with the Executive Directors that a country's having satisfied the performance criteria did not necessarily mean that the other objectives of the program had been met, the Deputy Director remarked. There were instances when performance criteria had not been met while other objectives had been reached, but that situation did not apply to Morocco. There was a logical connection between satisfying the performance criteria and achieving the targets. In fact, until the third quarter of 1982, both targets and performance criteria were those assumed in the program. Since the third quarter, expected foreign assistance had eluded the Moroccan authorities; subsequently, there had been a close connection between the deviation from the performance criteria and the deviation from the targets in the last quarter. The December criteria had been met partly because the performance criteria had not covered the buildup of domestic arrears or external debt of less than one year's maturity; the long-standing decision of the Board had enjoined the staff from prescribing ceilings on external debt of less than one year. The authorities had been able to borrow abroad short term and still meet the performance criteria because they had used those loopholes to finance additional expenditure. To take account of the experience of the past quarter, the performance criteria for the present year had been made broader and more comprehensive. They included short-term credits and external credit of less than one year, as well as separate procedures to deal with the temporary buildup of domestic arrears. The Moroccans were sincere in wanting the program to be successful; any deviation from the performance criteria would not endanger the targets.

A question had been raised as to whether the export assumptions made by the staff might not have been overly optimistic, the Deputy Director recalled. The main assumption was that the price of phosphates would rise about 7.5 percent annually between 1984 and 1985 in line with the expectation of a long-term association between the price of phosphates and that of petroleum. That relationship had prevailed in the past, except for the previous year and a half when the decline in the prices of phosphate had been much larger than that for petroleum, owing to the overall drought in southern Europe, which had reduced the demand for phosphates, and the payment in kind (PIK) program in the United States, which had further reduced demand. With a return to normal conditions in the fertilizer market, the former relationship between petroleum and phosphate prices would resume or catch up, and the staff believed that the forecast increase in phosphate prices would materialize.

With regard to petroleum, there would be little increase in prices from 1985 onward, the Deputy Director said. The 7.5 percent increase forecast for petroleum prices was merely the catchup expected from deviations in the relationship in the past, assuming that the drought would not continue during the coming years and that the adverse effect on the phosphate market of the PIK program would be somewhat modified. With regard to nonphosphate exports, the staff had not taken the previous volume of exports and merely extrapolated it; in fact, nonphosphate exports had been increasing at an average rate of about 10-11 percent a year. The staff had assumed that, notwithstanding the recession and not taking into account the recovery in the world economy, the increase in the volume of nonphosphate exports would be about 6 percent, below the trend in the past. The staff had used the assumptions in the World Economic Outlook regarding prices of commodities other than phosphates in the international markets. Short of unexpected developments, the assumptions had not been unduly optimistic either in terms of phosphate prices or in terms of volume increases in nonphosphate exports.

Directors had also asked whether the staff had not understated the amount of imports needed, the Deputy Director remarked. The staff's assumption of a decline in 1983 and 1984 was based on two considerations. First, there had been an unusually large increase in imports in 1982 because of the expansionary policies of the Government; therefore, there should be a policy of reducing imports without affecting the modest growth targets for 1984 and 1985. The impact of the price increases should not be underestimated, because the increases directly affected the consumption of goods that were generally imported, such as sugar, butter, flour, and oil. On the basis of the reaction to the increase in prices in 1980-81, the assumed decline in demand in 1983-84 as the result of price increases was justified. Second, the income effects of the decline in consumers' disposable income supported the overall import projections, assuming that other policies in the program were followed.

The staff had been asked whether forecasts for increased receipts from the state-owned phosphate company (OCP) were not overoptimistic, the Deputy Director recalled. There was no fiscal agreement between OCP and the Government setting out OCP's contribution. As a result, the annual amount had depended not so much on the financial viability of OCP as on the strength of personality of the Director of OCP and the Minister of Finance. The staff had tried to persuade the authorities to sign an agreement with OCP; however, in 1983-84--a year of projected depreciation of the dirham and of debt rearrangement--OCP would have a certain amount of liquidity that it should not be allowed to retain. As OCP clearly had a substantial amount of excess capacity, the staff did not believe that it was necessary for it to retain the funds to finance additional investment. On the basis of the staff's cash flow analysis of OCP, the amount mentioned--a small overall tax in terms of units exported--could easily be made available to the Government.

Directors had also asked what standards would be used in the review process to measure the performance of new taxes, education, and state enterprises, the Deputy Director continued. The program specified the type and timing of actions required. For example, on the taxation side, the staff expected the authorities to have the new tax in place and to start collecting revenues by July 1, 1984. With regard to education, measures would be taken governing stipends, scholarship requirements, and teacher recruitment; in addition, it was expected that during the year an agreement would be reached with the World Bank on a timetable for implementing other recommendations. There was little possibility of slippage because both timing and priorities were clear to the Moroccan authorities and to the staff; in any case, the performance would be evaluated at the time of the next review.

He agreed with the observation by several Directors that the adequacy of the adjustment efforts beyond 1984 needed to be explored further, the Deputy Director stated. The staff had indicated to the authorities that, given the balance of payments problems foreseen and the objective of a sustainable balance of payments position in 1987-88, it was important that adjustment measures in the existing program should be strengthened and supplemented by other measures. A further decrease in the budget deficit and an investment program leading to increased production and exports would both be useful. On the monetary side, a role would be allowed for interest rates as an allocative mechanism and as a positive reward for savers. More important, the adjustment should be supplemented by supply-side measures, such as structural measures in education, investment, taxation, state enterprises, and export promotion. In sum, to achieve the objectives of the program, a more comprehensive, rather than merely a strengthened, adjustment program might be necessary in the future.

Other Directors had asked about the content of the structural adjustment loan from the World Bank to finance a program of export promotion and diversification, the Deputy Director said. A study by the World Bank revealed that industries in Morocco received protection in the form of a special tax on imports amounting to 19 percent. In order to reduce discrimination against exports and to increase the incentive for exports, it would be necessary to decrease the tax. On the other hand, it played a special and important role on the fiscal side; if the special import tax were reduced, it would create problems in the budget. It would also give rise to a situation where the authorities would argue before Parliament that the depreciation would discourage imports by making them more expensive, while arguing that the reduced taxes on imports would increase imports. However, the principles for agreement had been reached, and negotiations with the World Bank were at a point where the Fund staff had stated that it could accept a somewhat higher deficit than indicated in the program for 1984 to take into account the net effect on the budget of the World Bank loan. Similarly, the amount of the loan would be taken into account in adjusting budgetary and current account targets.

The staff was aware that Directors expected firm assurances before the November review that the 1983 and 1984 financing gaps would be closed, the Deputy Director of the African Department remarked. That position had been made clear to the Paris Club as well as to the commercial banks, and it would be pursued in meetings with donors. The capital inflow forecast for 1984 was the amount under existing commitments, and it could be assumed that Morocco would continue to receive new commitments even in the absence of a special effort. By the time of the end-November review, the staff should be able to provide firm assurances that the gap was being financed. If not, in the course of the review the authorities could undertake additional measures in order to reduce the gap to the amount of financing available.

Mr. Kabbaj thanked the Executive Directors for their comments, which reflected their interest. Directors had referred to the number of programs prepared by Morocco and supported by Fund resources. However, Morocco had not had recourse to Fund resources in 1978. The first adjustment program had been concluded almost without recourse to resources, except for a small drawing from the Trust Fund. The first drawing by Morocco had taken place at the end of 1980 under the extended Fund facility. That extended arrangement had started well with the implementation of various measures; however, as pointed out in previous staff papers, 1981 had been a difficult year for Morocco, which had resulted, inter alia, in a slippage on the current account side, 80 percent of which was attributable to exogenous factors. In retrospect, Morocco's performance under that extended arrangement had not been at all bad when the magnitude of those exogenous factors were taken into account. In fact, in recent cases where similar slippages had occurred, the Board had recognized that the exogenous factors were overwhelming and had granted waivers on many of the performance criteria.

The second agreement with the Fund--a stand-by arrangement, coupled with a drawing under the compensatory financing facility--had been reached in 1982, Mr. Kabbaj continued. Looking at the current expenditure side of the budget, Morocco was on track except for a minor slippage, due to debt service. On investment, the outcome should not be described as a voluntary stepping up of expenditure. The bulk of ongoing projects fell at the end of the year because it was the central year of the plan; it was not the result of deliberate scheduling by the Moroccan authorities. Both the Moroccan authorities and the staff recognized that the performance criteria had been legally observed.

The program for 1983 was sound, and the magnitude of the adjustment effort was remarkable, Mr. Kabbaj stated. Given the need for political and social acceptability of the adjustment measures, he did not believe that Morocco could have done more. The Moroccan authorities had indicated their resolve through the timeliness and stringency of the measures taken to redress the situation in the first six months of 1983. On performance criteria, in order to avoid the problems cited by the Directors, the staff had, with the institution of the separate ceiling on short-term external debt and of a de facto ceiling on the overall deficit, taken extraordinary precautionary measures to avoid any slippage. The Moroccan authorities' recourse to short-term financing in 1982 would not be repeated in 1983, and the benefit of the doubt should be given to the authorities. At end-August 1983 the program had been on track, and, unless aggravated by exogenous factors, it would be fully observed. The program was back-loaded, and there were three reviews scheduled, an exceptional number for a stand-by arrangement of 18 months. In fact, the program covered three financial years, of which two were covered by performance criteria. As many Executive Directors had commented, the first drawing would be unusually small despite the firm understandings for 1984 on major policy items on both the budgetary and the balance of payments sides. It was also worth recalling the previous efforts made and the measures taken as prior actions.

With regard to the assumptions made, both the Fund and the Moroccan authorities relied on calculations by specialized international financial institutions, especially the World Bank, Mr. Kabbaj commented. Deviations from past assumptions on phosphate exports had resulted from unanticipated factors, such as the PIK program in the United States--which had reduced the acreages of the three principal corporations by 20 percent, thereby sharply reducing the consumption of phosphates--as well as from the drought in Europe.

Nonphosphate exports during the first six months of 1983 had increased, compared with the first six months of 1982, by 16.8 percent, Mr. Kabbaj noted. The increase argued that the program was on track.

On monetary policy, Mr. Kabbaj observed that the Bank of Morocco had implemented the measures in the previous and present programs promptly and fully. Morocco had never favored restrictions on trade or on exchange. If restrictions had been introduced at the beginning of 1983, it had been because of a pressing need following the fall in reserves. But the introduction of those restrictions had to be weighed against the fact that Morocco had continued to service its debt. Even while so doing, the authorities had agreed with the Fund to phase out restrictions within nine months and to return to the level of protection prevailing at the end of 1982.

He agreed with Executive Directors that the implementation of structural policies was at the heart of many of the problems faced by Morocco, Mr. Kabbaj noted. There was no lack of political will. The World Bank's report on education had not been completed before June 1983; that study and others recently completed had shown the authorities the path they should take, and they had started to implement many of the recommendations. The reform of the scholarship system had already begun as part of the 1982 program, and many other reforms had been introduced that had not yet affected the budgetary situation. Following discussions of the World Bank's recommendations with the banks, then with the Government, the authorities would be in a position to intensify their efforts to reduce the heavy burden of education on the budget. With regard to tax reform, the authorities had decided to act in two stages: first, to ask Parliament to approve a new tax code, which had been adopted in July 1983, while preparing the necessary enabling legislation; and, second, to work up a corporate income tax with technical assistance from the Fund. The Fiscal Affairs Department was sending a mission to Morocco shortly to continue work on the legislation. The mission would also discuss the value-added tax with the authorities; although that reform would be difficult, the authorities believed that it was essential if the program was to be carried out in full.

The authorities were conscious of the need to continue strong adjustment policies beyond 1984, Mr. Kabbaj stated, and they had accepted an implicit reduction in consumption by about 1 percent of GDP in every year until 1988, which represented a strong commitment on their part. He asked for the Board's understanding of the need for external assistance sufficient to make adjustment less burdensome and more acceptable socially and politically. On the important question of the financing of the gap, the Board was aware of all the efforts made by the authorities since mid-August. He thanked the Acting Chairman and the staff for the part that they had played in coordinating negotiations. Those efforts had been successful, and the prospects for closing the gap for 1983 were much better than they had been previously.

A World Bank mission was currently in Morocco discussing the final stages of loan negotiations with the Government, Mr. Kabbaj said. The structural adjustment to be implemented under the program included price liberalization of food products, petroleum products, and services. In the financial sector, in order to support the program with the Fund, measures would be taken to enhance short-term and medium-term export credit, the export credit insurance system, and the system of coverage against exchange rate risk. Action to improve the mobilization of financial savings and, in coordination with the Fund, to increase the interest rates on the checking accounts of Moroccan workers abroad and on sight deposits would also be taken. Tax reform would include revisions of the investment and export codes to make them more export oriented, as well as adjustments of taxes on goods and services. However, the bulk of adjustment would center on tariff and nontariff protection. The Moroccan authorities agreed with the World Bank that sharp reductions in nominal and effective tariff protection were required.

Mr. Erb observed that perhaps Directors' comments about the link between the performance criteria and the targets had been misinterpreted as criticism of the Government's integrity. The intent had been to point out that the purpose of performance criteria was to give government officials a warning signal when performance was being pulled off track. The important question was whether performance criteria were giving the right signals to the Government, the Fund, and the Executive Board, not whether the Government was trying to evade the criteria. Directors knew that decisions in most governments were made in a disaggregated manner; thus, a centralized monitoring system should be available to catch any variance. For that reason Directors had queried the technical nature of performance criteria and why they had not picked up developments that were leading to a sharp deviation from the more fundamental targets.

The Acting Chairman agreed that Mr. Erb had described the correct perspective. In the past, Morocco had not, apart perhaps from official activities, borrowed short term in international markets to a great extent; leaving aside the question of integrity, many countries--including Morocco--had been forced partly by international market conditions to borrow short term to a greater extent than before. As in other cases, the staff had thought it worthwhile to cover that situation from a number of points of view, including debt management and the external debt service.

The Deputy Director of the African Department commented that even though criteria were met, if there were deviations from the program, they should be pointed out to the authorities. In fact, since October there had been discussions between the Fund mission and the Moroccan authorities as well as a formal letter from the Managing Director to the King of Morocco pointing out that, notwithstanding that criteria had been met, there were problems with the implementation of the adjustment measures. The staff had not had the opportunity to indicate to the Board the problems that had arisen, because the program had been on target until October, and there had been no opportunity for a Board discussion following the receipt of the December data. The Moroccan authorities had tried to find ways of meeting the performance criteria in October and December. Nevertheless, they were aware of the additional peformance criteria in the present program, and they had given assurances of their determination to continue working in cooperation with the Fund. Taking into consideration Morocco's prior actions and the seriousness of the situation, he assumed that the performance criteria would be adequate.

The Executive Board then took the following decision:

1. The Government of the Kingdom of Morocco has requested a stand-by arrangement for the period September 16, 1983 to March 15, 1985 in an amount of SDR 300 million.

2. The Fund approves the stand-by arrangement set forth in EBS/83/178, Supplement 1.

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

Decision No. 7530-(83/142), adopted
September 16, 1983

2. ZAMBIA - STAND-BY ARRANGEMENT - MID-TERM REVIEW

The Executive Directors considered a paper on the mid-term review of the stand-by arrangement for Zambia (EBS/83/176, 8/18/83).

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

According to information recently received from Zambia, all the performance criteria for end-July have been observed. Furthermore, since the establishment of the new flexible exchange rate policy on July 6, 1983, the kwacha had depreciated vis-à-vis the U.S. dollar by 11.6 percent, and vis-à-vis the SDR by 10 percent by the end of August.

A new collective agreement between the mineworkers' union of Zambia and the mining company has been concluded, effective August 1, 1983. Under the two-year agreement, wage increases of union-represented employees will be limited to 10 percent. As one of the cost-cutting measures introduced in January 1982, the salaries of senior Zambian officials and expatriate employees remain frozen; therefore, the increase in the total wage bill of the mining company will be limited to 7.3 percent.

Agreement has been reached in principle regarding the rescheduling of Zambia's debts to international banks, and the agreement is expected to be signed shortly. Furthermore, the People's Republic of China has agreed to a rescheduling of Zambia's debt to that country. These agreements are broadly in line with the assumptions made in the staff report.

Mr. Sangare made the following statement:

My Zambian authorities welcome this review of the stand-by arrangement and found the exchange of views with the staff to be helpful in devising policy measures to be implemented during the remainder of the program period.

Despite the many important steps taken since the beginning of the year, including the 20 percent devaluation of the kwacha in SDR terms last January and the reduction in subsidies, Zambia's balance of payments continues to be under severe pressure, and the financial situation for 1983 is now less favorable than expected at the time that the program was launched. Because of the seriousness of the situation, the authorities realize that relentless efforts will be needed in future years to stabilize their economy and establish the basis for sustained growth. The latest measures agreed with the staff and outlined in the letter from the Prime Minister and Minister of Finance, attached to the staff report (EBS/83/176), are vivid proof that this awareness on the part of the authorities is being matched by concrete action, a move that the staff agrees merits continued support from the Fund.

Economic activity in Zambia is expected to remain at a low level in the current year, largely reflecting the scarcity of foreign exchange, the bulk of which is earned from exports of copper. It is therefore a matter of consequence that, apart from the adverse impact of the prolonged recession on copper earnings, disruptions of shipments of the TAZARA railroad earlier in the year precipitated an involuntary buildup of stocks, such that copper exports are now projected to fall short of the target by some 2.5 percent. This, combined with higher cash payments for the settlement of arrears, means that less foreign exchange will be available for imports, which are expected to be about 25 percent below their 1982 level, with negative consequences for economic growth.

In order to reduce the economy's dependence on copper, priority is being given to developing the agricultural sector. Production in the 1982/83 crop season is expected to be higher than in the previous year despite poor weather, reflecting in part the favorable response of farmers to increased producer prices. The authorities have already announced price increases for maize, soyabeans, wheat, and groundnuts averaging 22 percent, which should offset the impact of the increase in the price of fertilizer.

The slack in economic activity in Zambia and the lower level of imports, in the absence of additional revenue measures, would have likely resulted in a projected revenue shortfall of approximately K 80 million compared with the original program target. In order to keep the program on track, the authorities, on July 22, 1983, doubled the existing minerals export tax from 4 percent to 8 percent, a move expected to raise about K 29 million. This is being supported by increased efforts to collect existing taxes. Meanwhile, efforts have been intensified in the direction of containing public sector expenditure. Capital expenditure and net lending will be reduced by about K 50 million by cutting back outlays on a number of projects and stepping up receipts from public enterprises whose financial position has improved following the lifting of price restrictions. Recurrent expenditure will be reduced by K 20 million, reflecting lower transfer payments, reduced personnel costs, and savings in government interest payments.

The recent actions of the authorities are expected to contain the budget deficit at 5.7 percent of GDP, which is in line with the initial target. The authorities, however, are aware that further adjustments will be needed in 1984 and intend to discuss this matter with the Fund no later than mid-February 1984. Making adjustment for the large carryover of 1982 expenditures, the authorities intend to limit recourse to domestic bank financing to K 175 million.

Monetary policy is expected to be consistent with improvements in the financial position of the Government and the mining company, which has instituted further cost-cutting measures aimed at making its operation more profitable. While aiming at a moderate expansion in total credit, the authorities will make efforts to shift the composition of credit in favor of the private sector, especially agriculture. The Bank of Zambia credit to the mining company will not exceed K 170.5 million up to the end of December 1983. Broad money is projected to increase by 12.5 percent in 1983, less than half the expected rate of increase in nominal GDP. Interest rates were increased substantially last January, and no further steps are envisaged for the remainder of the year, the rationale, in part, being that private sector demand for credit has been weaker than expected.

As already mentioned, the Zambian kwacha was devalued by 20 percent in SDR terms in January, in keeping with the decision of the authorities to take a flexible approach to implementing exchange rate policy. This flexibility is expected to continue during the course of the year, and the authorities have stated their intention to review with the Fund matters relating to the exchange rate no later than November 30, 1983. On July 6, 1983, the kwacha was delinked from the SDR and pegged to a currency basket more reflective of Zambia's trading relations.

Zambia's overall balance of payments deficit is now projected to be smaller than expected at the start of the program. However, this situation should not be understood as an improvement in the underlying factors that affect the country's external payments position; rather, it is a reflection of the foreign exchange constraint that has forced a contraction in economic activity and continues to pose acute problems for the authorities in the face of a heavy debt burden. The staff has summed up the problem quite clearly by indicating that excluding any further debt rescheduling, reductions in non-Paris Club-related external arrears, or further use of Fund resources, there would be an uncovered financing gap of about SDR 300 million in 1984, which will remain high even up to 1987. There could be little doubt that this financing problem has been exacerbated by the prolonged recession in the international economy, which has kept the price of copper, Zambia's major foreign exchange earner, at a low level. Against this background, there can be no doubt as to the importance of further debt reschedulings as well as to the need for donor countries to provide more generous assistance to Zambia. Continued use of Fund resources will also be crucial to the adjustment process.

The staff has assured Directors that the thrust of economic policy is consistent with the objective of strengthening the country's balance of payments and the financial position of the Government. Meanwhile, my authorities have indicated their willingness to consult with the Fund in coming months and to reach such understandings as are necessary to improve the performance of the economy.

Mr. Orleans-Lindsay said that he agreed with the staff's appraisal and supported the decision. After a period of difficult economic and financial conditions in Zambia, the authorities had demonstrated their determination to implement strong adjustment measures to reduce the serious internal and external financial imbalances in order to establish conditions that would permit a sustained recovery in economic activity. The substantial progress that had been made was encouraging: recent information from Zambia indicated that all the performance criteria for end-July had been met.

Most significantly, the kwacha had been devalued and a flexible exchange rate policy adopted, Mr. Orleans-Lindsay continued. The prices for fertilizers and agricultural products had been increased. A general decontrol of wholesale and retail prices had also taken place. In the mining sector, which dominated the economy, the authorities had succeeded in reducing operating costs; he welcomed the information that, as part of the cost-cutting measures introduced in January 1982, the salaries of senior officials and expatriate employees remained frozen.

The financial position of parastatals had also shown a significant improvement after the removal of price restrictions, Mr. Orleans-Lindsay commented, and the authorities had made considerable progress in reviving agriculture. Furthermore, they had succeeded in obtaining a consolidation and rescheduling of external debt service payments and of accumulated external arrears. Although the implementation of the program seemed satisfactory, he was concerned that the internal and external financial prospects were likely to be more unfavorable for the remainder of the program period.

At EBM/83/63 (4/18/83), it had been stressed, inter alia, that the program was not only ambitious but that some of the staff projections seemed overoptimistic, especially in view of the adverse developments in the international market and the unfavorable prospects for Zambia's agriculture, Mr. Orleans-Lindsay recalled. As a result of the January 1983 devaluation and the decontrol of prices, GDP was expected to increase in nominal terms by 27 percent; in real terms, however, the Zambian economy would show no growth in 1983.

The volume of copper exports assumed under the program was expected to be 2.5 percent less than originally estimated, Mr. Orleans-Lindsay remarked. The expected improvement in the world price had not materialized, no doubt partly because of the buildup of copper stocks in an already depressed market.

The financial targets seemed to be on the high side, Mr. Orleans-Lindsay said. For example, a reduction in the budget deficit from 18.5 percent of GDP in 1982 to 5.6 percent in 1983 seemed a severe requirement in the circumstances of Zambia. The overoptimistic assumptions and relatively high targets should be revised, and he was pleased to note that the staff had done so in some cases for the remainder of 1983.

The kwacha had depreciated by 11.6 percent vis-à-vis the U.S. dollar and 10 percent vis-à-vis the SDR by the end of August 1983, Mr. Orleans-Lindsay noted. He welcomed the intention of the authorities to maintain a flexible rate, consistent with the program, and to keep the currency in close alignment with Zambia's relative competitive position. The authorities' action in 1983 to raise interest rates had been reflected in the significant shift toward quasi-money, with the share of quasi-money in the total rising from 48 percent to 52 percent. The intention of the authorities not to take additional steps in that area during the rest of the program period was understandable because of the slack in private sector demand for credit, although the Government's financial requirements were greater than expected. The decline in private sector credit was attributable to the slack demand for credit in agriculture and for imports, which was associated with the lack of foreign exchange. Nevertheless, the authorities intended to continue their cautious monetary and credit policy, consistent with the aim of improving the fiscal position and limiting net credit expansion and monetary growth to target levels.

Considerable progress had been made in debt rescheduling, Mr. Orleans-Lindsay remarked. The authorities had reached agreement with Zambia's official creditors resulting in more extensive debt relief than envisaged, indicating the confidence of Zambia's creditors in the authorities' determined adjustment efforts. Negotiations with creditor banks had been concluded, and agreement had been reached in principle. In addition, China had agreed to reschedule Zambia's debt to that country. In light of those events, he wondered whether the agreements were still broadly in line with the assumptions made by the staff in its report. He would appreciate further information regarding the rescheduling of Zambia's debt.

The results of Zambia's budgetary performance had been mixed, mainly because of the supplementary budget introduced in December 1982, which had created a large float of K 129 million, part of which had been used to eliminate domestic arrears, Mr. Orleans-Lindsay said. He wondered why such an important development had not been included in the program's financial targets. It was not surprising that the Government's borrowing requirements had turned out to be larger than expected, although the authorities had taken a number of fiscal actions to increase revenue and to contain total expenditure. In particular, their decision to double the minerals export tax and to introduce additional measures to raise revenue and to restrain recurrent capital expenditures seemed to be steps in the right direction. The authorities were determined to avoid a repetition of the 1982 carryover of expenditures. Therefore, as part of the effort to pursue further adjustment in 1984, the authorities' discussions with the Fund staff on the policy content of the 1984 budget should result in more realistic budget estimates in order to achieve the desired improvement in fiscal performance.

The Zambian authorities' adjustment efforts had been successful to date, Mr. Orleans-Lindsay commented. There was no doubt that more remained to be done to improve the domestic financial and foreign exchange prospects for 1983 as well as for the medium term. Success would depend to a large extent on future developments in the international copper market. In pursuing a policy of diversification and in subsequently giving priority to the development of agriculture and manufacturing, rather than mining, the authorities had been left with little room for maneuver. Creditors and donors would have to be even more forthcoming if Zambia was to achieve medium-term internal and external financial viability. The Consultative Group meeting scheduled for 1984 under the auspices of the World Bank would therefore be an important step toward the medium-term goal. Zambia's policies for strengthening its overall financial position deserved continued Fund support.

Mr. de Vries observed that Zambia was an example of those countries that could only choose between adjusting in a disorderly manner and adjusting in an orderly manner. Unless a country adjusted in an orderly manner, foreign exchange would run out, imports would no longer be available, and industrial activity would shrink. However, the Zambian authorities had taken a number of important measures, and there was the prospect of a more orderly, although painful, adjustment. Those measures already taken included a change in exchange rate policy, the depreciation of the currency, the liberalization of wholesale and retail prices, the rise in interest rates, and significant progress in consolidating external debt. Nevertheless, the budget situation was still difficult, and the country's competitiveness was weak, with wages outside the government sector rising despite government wage guidelines. The Zambian authorities would have to impose further restraint and market discipline. However, demand restraint would be insufficient, and proper preparation with the World Bank for the Consultative Group meeting in early 1984 would be desirable and beneficial to the country.

Mr. Taylor remarked that the Zambian authorities faced a difficult task in establishing the conditions for economic recovery. It would require both sustained effort on the part of the authorities and continued support by the Fund and Zambia's other external creditors. Successful completion of the present arrangement would be very important in laying the foundation for future Fund support over the medium term. The authorities had done well to implement most of the measures envisaged in the program in difficult circumstances. He commended them for the flexibility and determination that they had recently shown in introducing new measures to put the program back on track. It would not be easy to sustain that degree of effort, but he encouraged them to persevere in order to allow the economy to receive the full benefit of the measures already taken. He could support the proposed decision, although he believed that to some extent the proposed adjustments were harsh.

On fiscal policy, the authorities' determination to limit the deficit to 6 percent of GDP compared with the equivalent of 18 percent of GDP in 1982 was welcome, Mr. Taylor said. The sizable overrun the previous year had been unfortunate but had resulted mainly from the action taken by the authorities to clear domestic arrears, in itself a highly commendable objective. However, the overrun from the 1982 supplementary budget had complicated the process of budgetary control, and he welcomed the authorities' commitment to refrain from introducing further supplementary allocations. The intention to reduce both capital and recurrent spending in the present year and the recent improvement in tax collection and revenue raising were commendable. He urged the authorities to continue fiscal restraint; they should consider amending the system of company taxation, a possibility that his chair had mentioned during the April 1983 discussion.

He had some concerns about monetary policy, Mr. Taylor noted. The end-April criterion on net claims on the Government by the banking system had been substantially exceeded, and the staff was proposing a modification. Like Mr. Orleans-Lindsay, he was surprised that the problem had not been foreseen. At the outset of the program, the staff had been aware of the supplementary budget, which had resulted in K 60 million worth of uncleared checks drawn on the Government remaining outstanding at the end of 1982. Had the authorities offered the staff any estimate of the likely effect of the supplementary budget? Had they foreseen that the inevitable result would be a large float of outstanding claims? If not, it would still be surprising that the likely increase in net claims had not been foreseen at the time that the Fund had approved the stand-by arrangement in April. He would appreciate staff comment on whether all outstanding claims had been cleared, bringing performance under the criterion back on course. If so, it was not clear whether the temporary overshoot warranted the degree of tightening implied in the new program.

Table 4 in the report showed that the ceilings on the claims by the banking system on the Government would remain unchanged for the remainder of the year, Mr. Taylor continued. Assuming that the K 60 million overshoot was included in the figure of K 2.1 billion shown for April, the increase in claims on the Government permitted for the remainder of the year was only some K 50 million, a significantly lower rate of increase in net claims than the original ceiling of K 75 million for April-December. Was that tightening justified by the nature of the overshoot that had occurred? Because the ceiling was to remain unchanged throughout the second half of the year, strict control by the authorities on their borrowing would be necessary. It would be helpful if the authorities could speed up the collection of monetary data to facilitate the timely regulation of credit.

On the supply side, he commended the authorities for their courageous implementation of general price decontrol, particularly the increases in the prices of maize and fertilizer, Mr. Taylor said. Wage restraint would have an important part to play in ensuring the success of the financial program, and he was pleased that the mining unions had accepted a 10 percent limit on the maximum average wage increase for the year.

In the external area, he welcomed the general improvement in the balance of payments, primarily reflecting an estimated 25 percent decline in imports, Mr. Taylor remarked. It would be important to ensure that imports were not further reduced during the program, especially as exports had not risen as quickly as hoped. The authorities' efforts to diversify the export base through agricultural development were praiseworthy. However, diversification away from the dominant copper industry was difficult, in part because of the drought that had set back agricultural production. He encouraged the authorities to persevere with diversification, as it would have an important long-term role in the recovery and development of the economy.

He welcomed the authorities' commitment to maintain a realistic level for the kwacha and their intention to maintain a competitive position, Mr. Taylor commented. The delinking of the kwacha from the SDR and its pegging to a new basket of currencies represented a major step forward and should facilitate the pursuit of a flexible exchange rate policy in the future. Considerable progress had been made in debt rescheduling, although bilateral agreements with creditor countries under the terms of the Paris Club agreement remained to be signed before the end of the year. Nevertheless, the revised debt service ratio for 1983 was estimated at 38 percent, an uncomfortably high figure.

He had some slight concerns about the phasing under the proposed arrangement, Mr. Taylor remarked. Table 1 of EBS/83/176 indicated that drawings had been rephased so that only SDR 45 million would be available before the next staff mission to Lusaka in November. Given Zambia's severe foreign exchange shortage, that backloading of disbursements from the Fund came at an awkward time for the authorities, and it could have adverse effects on the adjustment process. For example, it presented the danger of encouraging the authorities to resort to further borrowing to ensure an adequate cash flow to handle the targeted reduction in external arrears. If that occurred, the borrowing would complicate the fulfilling of other targets under the program. He would appreciate staff comment on the reasons for proposing the change in phasing. Was it vital to the overall strategy undertaken by the authorities?

It was clear that both creditors and donors would have to be more forthcoming in the future in assisting Zambia through the difficult period ahead, and a Consultative Group meeting was urgently required to help meet the financing gap, Mr. Taylor stated. However, a commitment by the Fund to support the adjustment efforts over the medium term was highly desirable; therefore, the present program must remain on track. The rephasing of drawings in the early part of the program meant that the effort required of the authorities to meet their targets and satisfy the Fund staff during the November mission would be great; the next few months would be vital, and he hoped that the authorities would be successful.

Mr. Lovato commented that the Zambian authorities had accomplished a great deal, but that much remained to be done to reduce substantially the domestic imbalance and to create a position from which to advance to sustained development. The country had many problems still to be solved, but it was following the right course; he hoped that the program could be brought to a satisfactory conclusion. Areas of concern were the still worrisome medium-term balance of payments situation and the extensive debt problem, aggravated by cash outlays associated with debt rescheduling and the discouraging prospects for copper prices. Although he was in favor of preliminary discussions of a program that could be supported by further use of Fund resources during 1984, he pointed out that more emphasis should be placed on a more varied infrastructure. In conclusion, he supported the decision.

Mr. Laske pointed out that the position of the Zambian economy remained difficult. Although most of the corrective measures envisaged under the stand-by arrangement had been implemented and the performance criteria as of end-July had been observed, no significant improvement could yet be perceived in the financial situation, either internally or externally. In response to those unfavorable developments, the authorities had taken additional measures since July to ensure that the objectives of the program could be achieved. A major element was the maintenance of an appropriate exchange rate level. The devaluation of January 1983 and the subsequent change in exchange rate arrangements showed that the authorities were adopting a more realistic approach. The kwacha had depreciated further following the adoption of a peg to a basket of currencies.

Because copper provided the bulk of Zambia's export receipts, the performance of mining companies was critical, Mr. Laske observed. In the past, persistent operating deficits had been a constant budgetary burden, thus contributing to monetary expansion. He was pleased to note that the situation had changed, and that the mining company was expected to operate on a profitable basis. The maintenance of the company's profitability would depend on two factors: exchange rate performance and the outcome of wage adjustments. The original assumption had been that nominal wages would be increased in 1983 by no more than 5 percent. In fact, the wage settlement provided for an effective increase of more than 7 percent when certain exclusions were taken into account. Despite that overshooting of the wage policy target, the mining company was expected to become profitable, mainly as a result of exchange rate adjustment and despite the recently increased tax on exports. The effects on wage settlement and taxes demonstrated the importance of a realistic exchange rate policy for the performance of the Government's finances. He was therefore pleased that the appropriateness of the exchange rate would be considered during the review of the arrangement to be concluded before the third disbursement could be effected. In addition, every effort must be made to curtail the operating costs of the mining company through efficient and effective management.

The budget had been negatively affected by the clearing up of domestic arrears in late 1982, with its subsequent effect on the current year's budget and financing needs of the Government, Mr. Laske observed. As a result, the ceilings on domestic assets and bank credit to the Government for the remainder of the stand-by period had had to be raised over those set when the program had been established. He hoped that the Government would ensure that there would be no recurrence. The comprehensive credit ceiling for April 1983 would not have been met so comfortably had it not been for the subdued credit expansion to the private sector, which in turn reflected a depressed state of economic activity in Zambia.

Although interest rates on lending and deposits had been raised in line with the commitment under the stand-by arrangement, the present maximum interest rates appeared to be negative in real terms when measured against the expected rise in consumer prices, Mr. Laske noted. Because of the change in the composition of the monetary aggregates that had taken place, the authorities did not plan to make further interest rate adjustments. He wondered whether they were justified in their intentions in view of present expectations, which included price increases of 25-30 percent over the course of the year.

The balance of payments position remained strained, Mr. Laske commented, despite more extensive debt relief than envisaged earlier and a smaller overall deficit. However, that deficit would be financed exclusively by the use of Fund resources. Part of the disbursements from the Fund would be used to reduce external arrears, which was not an ideal situation. Nor was the outlook for the next two years encouraging. Despite the projected reduction in the current account deficit, the overall deficit would increase and, without further debt relief, might be unsustainable. The Zambian authorities had to make strong efforts to improve the trade balance; however, prospects for Zambia's major export commodity--copper--were uncertain. He hoped that the demand for copper would pick up along with the ongoing recovery in the industrial countries, which might also support a worldwide price increase for copper. It should not be overlooked, however, that a structural change in the demand for copper appeared to be under way. During the period of high copper prices, substitutes had been introduced in many fields, such as optical fibers. It was imperative therefore that Zambia should pursue vigorously the diversification of its export base into other commodities, such as agricultural products, for which the country seemed to have a competitive edge. A realistic exchange rate policy should enable Zambia to explore those possibilities more fully.

Although the present mid-term review did not focus in depth on the structural problems of Zambia, he hoped that in future Article IV consultations, and possibly in later stand-by or other arrangements, the structural question could be addressed as had been done in previous cases, Mr. Laske suggested. He supported the proposed decision.

Mr. Joyce congratulated the Zambian authorities for their resolution in implementing the adjustment measures envisaged in the program. He was impressed that in those cases where the program criteria for end-May had not been met, the authorities had quickly taken steps to get the program back on track. He commended the authorities for their determination to take the necessary measures to ensure success.

He was concerned that the foreign exchange and domestic financial prospects for 1983 were less encouraging than originally envisaged, Mr. Joyce remarked. The weaker market for copper, the disruption in shipments occasioned by the breakdown in transportation to the coast, the overall weakness in the economy, and the higher down payments associated with debt rescheduling would have led to low imports, shortfalls in revenue, and a continued expansion of net bank credit to the Government unless the authorities had taken corrective action. The revenue and expenditure measures introduced in July were commendable. They should strengthen both the fiscal position and the balance of payments prospects. He also welcomed the reduction in subsidies, the move toward freer prices, the devaluation of the kwacha, and the pegging to a new basket of currencies.

The Fund program was being pursued resolutely and with some degree of success in the short term, Mr. Joyce observed. However, Zambia's prospects for the future were worrisome. The overall balance of payments deficit at the end of the program would still be large, and Zambia would clearly have to make further adjustments, especially if the structural changes in the copper sector, mentioned by Mr. Laske, took place. Zambia would require large inflows of aid in 1984 onward, and he therefore welcomed the proposed meeting of the Consultative Group, under the auspices of the World Bank, scheduled for 1984. It was important that the arrangements for debt relief be completed as quickly as possible in order to assure that the financing gap could be closed in 1984.

The balance of payments outlook emphasized the need for Zambia to remain internationally competitive, Mr. Joyce stated. He welcomed the determination of the authorities to oppose excessive wage settlements and to avoid any general increases in public sector wages. Restraint in the private sector had not been as successful. Zambia's dependence on exports reinforced the need for continued wage and income restraint in all sectors of the economy and emphasized the importance of the authorities' pursuit of a flexible exchange rate policy. He was pleased to note that the authorities would be discussing exchange rate developments with the Fund on the occasion of the next review.

It would not be enough for the authorities to bring costs in traditional export sectors under control, Mr. Joyce continued; Zambia must seek to diversify its economy, however difficult that endeavor. The authorities must aggressively pursue policies that would encourage more investment and more production in nontraditional areas, leading to the diversification of the export base as well as the restoration of Zambia's agriculture and the reduction of dependence on imported foodstuffs.

He congratulated the Zambian authorities for their success to date, and he believed that Zambia was on the right track, Mr. Joyce said. He urged the authorities to pursue the medium-term objectives with the same firmness and determination that they had demonstrated in the past.

Mr. Suraisry commented that he was in agreement with the staff's analysis and supported the proposed decision. Since the beginning of 1983, under the one-year stand-by arrangement, the Zambian authorities had taken strong and widespread measures to reduce the serious imbalances of their economy. It was unfortunate, however, that despite the strength and diversity of those measures, the country's financial position remained weak, and the medium-term outlook for the balance of payments was not encouraging. The large shortage in foreign exchange had inevitably led to a reduction in imports greater than envisaged under the program; consequently, economic activity had deteriorated, necessitating additional adjustment measures. He commended the authorities for their efforts.

In the fiscal area, the reduction in imports had been the major cause of the difficulties faced by Zambia, but it was also true that the unexpectedly large supplementary budget introduced at the end of 1982 had also contributed to increased borrowing from the banking system, Mr. Suraisry continued. He welcomed the authorities' commitment to avoid repeating that experience. To contain the budget deficit, the authorities had taken several measures to increase revenue and reduce expenditure.

Those measures had proved to be necessary in light of the current economic situation; however, the doubling of the minerals export tax might have to be modified when the fiscal position improved, to avoid discouraging exports.

The restrictive monetary policy was necessary under the circumstances, and he welcomed the authorities' intention to continue that policy stance, Mr. Suraisry stated. Although it was encouraging that private sector credit would be increased, in the light of the difficult economic situation the 15 percent target might be optimistic. The authorities must exercise vigilance in wage policy. He was pleased to note that the salaries of government officials remained frozen and that the collective agreement between the mineworkers' union and the mining company had been concluded.

The authorities had devalued the kwacha at the beginning of 1983 and were adhering to a flexible exchange rate policy, Mr. Suraisry noted. However, because of the large debt burden and the lack of foreign exchange, the situation was not encouraging. An improvement would depend on the cooperation of all creditors, the provision of more debt relief, and a follow-up program with the Fund.

Mr. Agah remarked that Zambia's performance under the one-year stand-by arrangement had been mixed during the months since its approval by the Executive Board, despite the implementation of all the measures and policies provided for in the economic and financial program. The policies adopted by Zambia had been comprehensive and largely consistent with the magnitude of the country's economic difficulties, including unsustainable fiscal and external deficits, inflationary pressures, price distortions, and a substantial accumulation of external payments arrears. The program targets, which seemed unrealistic to some Executive Directors because of the sharp adjustment expected to be achieved in one year, were indicative of the authorities' commitment and were supported by strong and courageous measures covering all sectors of economic policy. They included a large depreciation of the kwacha, the adoption of a flexible exchange rate policy, fiscal measures aimed at containing expenditures and sharply increasing revenues, a general price decontrol, and adjustments in the prices of imported and subsidized goods, the streamlining of the mining companies, and increases in interest rates.

While substantial progress had been achieved since the adoption of the program, the outcome with respect to fiscal and external targets had been generally unsatisfactory, Mr. Agah commented. Although the current account deficit was projected to be even lower than the program target, it was attributable more to the emergence of unforeseen difficulties than to real external adjustment. Indeed, the lack of foreign exchange would result in a forecast 25 percent cut in imports, with a subsequent adverse impact on both industrial activity and the government budget. With regard to the fiscal deficit, because of a large shortfall in revenues it was expected to exceed substantially the program target of 5.6 percent of GDP and to increase the level of bank credit to the Government to more than double the program's indicative limit unless additional corrective measures were implemented.

It was encouraging that the Zambian authorities were taking additional measures of fiscal restraint to ensure the realization of the program's initial targets, despite an economic and financial environment much less favorable than envisaged, Mr. Agah noted. The new set of measures focused on the need to tackle the budget deficit and provided, in particular, for a large contribution by parastatals made possible by a significant improvement in their financial position as a result of price decontrol. The authorities were also doubling the minerals export tax, stepping up tax collection efforts, and scaling down capital outlays. They planned to raise additional nonbank financing to avoid excessive recourse to bank credit.

Despite a successful performance under the program and the continuation of serious adjustment efforts by the authorities, the medium-term prospects would nonetheless remain weak, Mr. Agah remarked. The financing gap was projected to remain large until 1986. Economic viability in Zambia could be sustained only through further adjustment efforts and a forthcoming attitude on the part of external creditors and donors. However, the achievement of sustainable improvement would depend mainly on strong real growth and a diversification of economic production that would reduce Zambia's excessive reliance on copper.

Mr. Williams said that he was in general agreement with the staff appraisal and supported the proposed decision. He commended the Zambian authorities for implementing the program and for taking additional actions as needed. Particularly important were the flexible exchange rate policy, the revenue-raising measures, the reduction in budget subsidies and outlays, general price decontrols, increased agricultural prices, wage restraint, more efficient operation of the mining industry, interest rate increases, and improved external debt management. The authorities might have to continue along the same lines for the next few years.

He commended the staff for its work in assessing Zambia's medium-term prospects, Mr. Williams concluded. It was clear that the next several years would be difficult; a combination of more adjustment by Zambia with additional financing from the Fund--and more important from non-Fund sources--would be needed to make Zambia's medium-term external position viable. He would be interested in staff comment on the phasing of the arrangement.

The staff representative from the African Department recalled that a number of Directors had observed that the adjustment effort was perhaps overambitious. However, it must be kept in mind that the present balance of payments situation was precarious. In addition, the medium-term prospects for Zambia were not encouraging; a possible scenario outlined in Table 9 (EBS/83/176) included a key assumption on the price of copper in the future, but if the price increase turned out to be lower than foreseen the situation would become even more difficult. The staff had concluded that there was an urgent need to persist with a strong adjustment effort and had been encouraged that the Zambian authorities had taken the additional measures to stay close to the original path foreseen in the program. Further adjustment during the second half of the year, particularly in the budget area, would be difficult, but the Zambian authorities were determined to persevere with their effort.

Issues relating to diversification and structural change had not been highlighted in the paper because the staff believed that it was unnecessary to focus on those aspects during the present review, the staff representative stated. However, Executive Directors would recall that in 1981 there had been an attempt to improve the situation through an extended arrangement dealing extensively with the need for diversification and structural change. Unfortunately, that program had been overwhelmed by unforeseen changes in the international environment, in particular, the sharp fall in the price of copper. As a result, the Zambian authorities had been compelled to devote their energies to defusing the short-term crisis, but the staff and the Zambian authorities continued to believe that the medium-term solution to their problem lay in diversification and structural change.

The staff was pleased that relations between Zambia and the World Bank had become closer, the staff representative said. Agreement had been reached on a letter of developmental objectives, and they were working together on the elaboration of the medium-term investment program that could be the basis for the Consultative Group meeting scheduled to convene early in 1984. He looked forward to reporting progress along those lines in any future programs for 1984.

Several Directors had asked why the staff had not foreseen the large float of checks issued late in 1982, the staff representative recalled. The staff had been aware of the supplementary budget approved in November 1982, and of the large expenditures being made in part to absorb some of the accumulated domestic arrears. However, neither the staff nor the Zambian authorities had foreseen the magnitude of those expenditures, nor had they imagined that a large number of the checks issued in 1982 would be cashed only in the first few months of 1983. The incident indicated a defect in the authorities' expenditure control mechanism; they had requested technical assistance from the Fiscal Affairs Department in improving expenditure control and monitoring in the future.

It had been commented that the current fiscal adjustment was somewhat harsh, the staff representative continued. The staff believed that the harshness was necessary because of the difficult balance of payments situation and the additional expenditures that had taken place. If the staff could have foreseen the higher expenditures, the program would have been designed differently. In view of the urgent need for adjustment, those additional expenditures could not be allowed to be covered fully by additional bank credit; the exceptional float had to be absorbed by additional measures during the year.

With regard to the phasing of the stand-by arrangement, the staff representative remarked that, because of adverse developments, performance criteria at end-April and end-May had not been respected. It had taken some time to complete the present review, requiring both a staff visit to

Zambia and two visits by the Zambian authorities to Fund headquarters. In view of the precarious nature of the balance of payments and the dropping of one purchase because of the nonobservance of Fund criteria, the staff had believed it preferable under the circumstances to distribute half of the missed purchase to each of the last two purchases, which could be made upon observing the October and December performance criteria, a practice that had been followed in similar cases.

The staff would review company taxation and other matters pertaining to the 1984 budget in future contacts with the Zambian authorities, the staff representative from the African Department stated. Further interest rate changes would be desirable in the future, and the staff would discuss that issue with the Zambian authorities in the context of discussions regarding a possible 1984 program.

Mr. Sangare thanked Directors for the understanding that they had shown of the difficult conditions under which the Zambian authorities were adjusting. The stringency of the measures taken by the authorities indicated their determination to address their difficulties. Fiscal, monetary, wage, and exchange rate measures had been taken, but the medium-term prospects for the balance of payments remained gloomy. Zambia's main task was to diversify and restructure the economy, but the foreign exchange shortages being experienced by the country made it impossible to obtain the necessary imports required for economic development. The solution therefore lay not only with the Zambian authorities but also abroad. Zambia's economy was based mainly on one export--copper--whose price and demand prospects were not improving. Unless there were enough assistance from donors, either bilaterally or multilaterally, diversifying and restructuring the economy would be difficult. The support of the Fund and donors' contributions would be necessary to assist Zambia in diversifying and restoring its economy in such a way that the balance of payments would in due course become viable.

He supported Mr. Taylor's proposal regarding the phasing of the stand-by arrangement, Mr. Sangare said. He hoped that during the following year it would be possible to rephase the drawings to permit the Zambian authorities to cooperate with the Fund while reaching their objectives. The authorities were committed to addressing the situation, and they were open to suggestions from the staff on such issues as the exchange rate; as a result of discussions, they had detached the kwacha from the SDR and linked their currency to a more manageable currency basket.

The Executive Board then took the following decision:

1. Zambia has consulted the Fund in accordance with paragraph 4 of the stand-by arrangement for Zambia approved by Decision No. 7383-(83/63), adopted April 18, 1983, and the fourth paragraph of the letter of February 25, 1983, attached to the stand-by arrangement for Zambia (EBS/83/67, Sup. 1) in order to review progress under the program and to reach understandings with the Fund on performance criteria for the remaining period of the program, as well as on exchange rate and interest rate policies.

2. The letter of the Prime Minister and Minister of Finance dated August 16, 1983, shall be attached to the stand-by arrangement for Zambia and the letter from the Prime Minister and Minister of Finance dated February 25, 1983 shall read as supplemented and modified by the letter of August 16, 1983.

3. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 76.5 million until November 30, 1983, and SDR 144 million until February 15, 1984.

(b) None of the limits in (a) shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Zambia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

4. Zambia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Zambia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) During any period in which the data at the end of the preceding period indicate that

(i) the target for reduction in external payments arrears described in paragraph 4 and Attachment I of the annexed letter, or

(ii) the understanding concerning arrears under debt rescheduling agreements described in paragraph 4 and Attachment I of the annexed letter, or

(iii) the limit on total net domestic assets described in paragraph 11 and Attachment I of the annexed letter, or

(iv) the limit on net credit to the Government described in paragraph 11 and Attachment I of the annexed letter, or

(v) the limit of Bank of Zambia credit to ZCCM described in paragraph 11 and Attachment I of the annexed letter has not been observed, or

(b) After November 30, 1983, until the review contemplated in paragraph 8 of the attached letter is completed, or

(c) After February 15, 1984, until the review contemplated in paragraph 10 of the attached letter is completed.

Decision No. 7531-(83/142), adopted
September 16, 1983

3. PANAMA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the review under the stand-by arrangement for Panama (EBS/83/192, 9/6/83).

Mr. Arias made the following statement:

My Panamanian authorities are in broad agreement with the staff report, which they consider adequately describes the policies that have led to across-the-board overperformance under the present stand-by arrangement.

My authorities recognized that in order to improve the economy, steps of a far-reaching nature needed to be taken to put the public finances on a sound footing. Thus, a strict fiscal policy has been pursued through tight control of expenditure and new revenue measures. These policies were discussed in detail on the occasion of my authorities' request for the arrangement that entered into force last June. I should like to emphasize that Panama's economic and financial performance in 1983 attests to the decisiveness with which my authorities have carried out the implementation of the program. I also would like to note that in recent days, additional measures have gone into effect to further limit public spending. Consumption of gasoline by the public sector has been severely restricted and limited only to essential uses. Telephone service to the public sector also has been curtailed by 20 percent to eliminate superfluous use and to expand the availability of the telecommunications network to the private sector. Also, as the staff paper pointed out, my authorities--since last May--implemented a hiring freeze and are determined to continue with this policy despite the existence of budgetary allocations for some new positions. The public sector revenue performance has been better than expected, as a reflection of the important measures adopted at the beginning of the year and strengthened tax administration.

With regard to the $278 million bank loan that was required under the financial program to cover scheduled amortization of commercial debt in 1983 and 1984, I would like to communicate to the Executive Board, on behalf of my authorities, that the placement is nearing completion and signing is expected to take place by the end of this month. My authorities wish to express their gratitude to management and the staff for the support given when negotiations on this loan were being conducted with the international banking community.

Finally, my authorities would like to reiterate their intention to continue working and cooperating closely with the Fund.

Extending his remarks, Mr. Arias said that Panama had been reviewing its import tariff policies during the past seven months. A number of items previously subject to quota restrictions had been made subject to import tariffs. The Cabinet had approved the conversion following close coordination with the World Bank, enabling that institution to proceed with plans to present the structural adjustment loan to the Executive Directors in the near future.

Mr. Delgadillo commented that the Panamanian authorities had shown great determination in undertaking the necessary adjustments under the present stand-by arrangement. All the quantitative targets established under the program had been met comfortably. The centerpiece of the adjustment effort had been the reduction of the overall deficit in the nonfinancial public sector from B 238 million in the first half of 1982 to B 73 million in the same period of 1983, the result of a combination of expenditure restraint amd increased revenue. He welcomed the additional measures mentioned by Mr. Arias, which reflected the full commitment of the authorities to improve Panama's economic performance. Indeed, Panama had made full use of one of the few instruments available to the authorities, namely, fiscal restraint.

Panama's economy depended to a great extent on services provided to international commerce, Mr. Delgadillo observed. The unfavorable conditions in the international economy had had an adverse impact on the country's major trading partners, and foreign lenders had reduced their exposure. Those developments, together with constraints on the effective use of exchange rate policies, had led to a more intensive use of public finance policies. With the easing of the fiscal account, the future use of Fund resources could help to strengthen the position of the country. The authorities had realized that it was not possible to sustain large fiscal imbalances and high external indebtedness as a means of protecting the economic activities from recession in the short run. It would have been interesting to have the staff's analysis of the medium-term outlook for the Panamanian economy and to have more information on the findings and recommendations of the World Bank on the structural adjustment loan, negotiations for which were nearly complete. The early conclusion of a loan agreement with the World Bank was an important step for the future of Panama's economic performance. The second review should address that issue, particularly the establishment of targets and performance criteria for 1984. It was clear that the authorities were making a significant effort to tackle the main problems of Panama, and he supported the proposed decision.

Mr. Senior said that he welcomed the review under the stand-by arrangement for Panama and that he was in broad agreement with the staff appraisal. The improved financial performance of Panama under the stand-by arrangement had been the result of the forceful and timely implementation of a series of measures, indicating substantial progress in attaining the program's objectives. The authorities should be commended for the determination that they had demonstrated in implementing the program, especially considering the adverse external circumstances that they had been facing, particularly in other Central American countries. Better than expected improvement in the public finances reflected the higher than expected revenue and strict enforcement of expenditure control. Revenue measures such as tariff increases, replacing quota restrictions on a large number of imported goods, and increases in taxes and tariffs in the public sector, had started to produce the desired results. Simultaneously, new restrictions on public spending had ensured the intended use of resources, eliminating possible waste. Equally important, the Government had decided in May 1983 to impose a freeze to keep public wages below projections.

Consumption of gasoline and the use of telephone services in the public sector had been reduced, resulting in reduced deficits, Mr. Senior continued. Current expenditures of the public sector up to June 1983 had been 6.5 percent lower than expected in the program. As a result of those revenue and expenditure measures, the deficit of the nonfinancial public sector had amounted to less than half the ceiling originally contemplated in the program, leaving an ample margin for achieving the desired position for 1983 as a whole. He welcomed the information that negotiations for a $278 million loan from the international banking community, required to cover payments for 1983 and 1984, were expected to be completed before the end of September 1983.

Mr. Pickering commented that the report provided a generally encouraging assessment of the progress achieved under the current stand-by program, and he could endorse the proposed decision. All criteria had been observed, although the economy continued to experience weak growth.

He attached considerable importance to the progress made in the fiscal area through reductions in investment spending, Mr. Pickering remarked. He hoped that the authorities would be able to recover from slippages that had occurred in the implementation of the revised core program, especially construction of the hydroelectric plant and the housing project. He welcomed the progress made in negotiations with the World Bank on a structural adjustment loan, and he hoped that those efforts would come to fruition in the fall of 1983.

The authorities had reduced the net commercial borrowing of the public sector, Mr. Pickering continued, and had been successful in covering the amortization payment on the external commercial debt falling due in 1983 and 1984; the large external debt had placed a serious constraint on the economy. The authorities should persist in their adjustment efforts in order to provide a strong base upon which the benefits of the global recovery in trade could be realized. The margin with which the performance criteria had been surpassed should not be lost through any relaxation of policies. The proposal to set aside a portion of the Fund purchases to strengthen the foreign reserve position of the National Bank merited consideration. He looked forward to an equally successful review in January 1984.

Mr. El-Khouri noted that Panama's performance under the current stand-by arrangement had been successful. Quantitative performance criteria for the first half of 1983 had been met comfortably. Negotiations with the World Bank for a structural adjustment loan had proceeded smoothly, and Panama had put in place all the measures necessary to qualify for the loan. He was pleased that the placement of a $278 million commercial bank loan was nearing completion. He commended the authorities on their achievements and encouraged them to continue their adjustment effort. He agreed with the staff's appraisal and supported the proposed decision.

Mr. Williams commended the authorities for Panama's performance under the stand-by arrangement and supported the proposed decision. He agreed with the staff appraisal; in particular, he wished to emphasize the point made in the last paragraph: to the extent that fiscal performance turned out to be better than expected, a portion of the Fund purchases should be set aside to strengthen the foreign reserve position of the National Bank. Another option would be not to draw down from the Fund so that resources would be available in the future.

On a procedural matter, even taking into account the flexibility required around the time of the Annual Meetings, his authorities had problems with the drift toward the shorter time period permitted for the review of programs, Mr. Williams remarked.

The staff representative from the Western Hemisphere Department commented that, with regard to the medium-term prospects for Panama and the description of the content of the structural adjustment program, Panama was one case where most of the measures negotiated with the World Bank in conjunction with the structural adjustment loan had been adopted well before the actual loan disbursement. Most of the required actions had been taken in early 1983, while the loan was expected toward the end of the year. For that reason, the staff had been able to describe the program in the paper presented to the Executive Board in conjunction with Panama's request for a stand-by arrangement.

The medium-term prospects for the economy were not very good, the staff representative continued, mainly because the problems in the rest of the hemisphere were creating slack demand for Panama's goods and services. One possibility of improvement was the response to the incentives that Panama had put in place to foster productive initiatives by the private sector.

The present review was one of two scheduled under the current stand-by arrangement, the staff representative from the Western Hemisphere Department observed. At the time of the next review, during which the program performance criteria would be quantified for the following year, there would be an opportunity to discuss developments in the economy more thoroughly.

Mr. Arias remarked that his authorities wished to improve the public finances of Panama; they would therefore continue their efforts to accomplish that goal. He thanked Executive Directors for their interesting comments.

The Executive Board then took the following decision:

> The Fund and Panama have conducted the review of the progress made in implementing the program pursuant to paragraph 4(b) of the stand-by arrangement for Panama (EBS/83/102, Sup. 1) and paragraph 21 of the letter of intent of April 29, 1983, attached thereto, and concluded that no new understandings are necessary regarding circumstances in which purchases may be made by Panama until January 15, 1984.
>
> Decision No. 7532-(83/142), adopted
> September 16, 1983

4. BAHRAIN - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Bahrain (SM/83/158, 7/14/83). They also had before them a report on recent economic developments in Bahrain (SM/83/162, 7/27/83).

Mr. Finaish made the following statement:

> A major focus of economic policy in Bahrain in recent years has been the need to broaden the base of economic activity, which has long depended heavily on the oil sector. Compared with those of many other oil producers, Bahrain's oil reserves are limited. The availability of other natural resources--except gas--is also relatively limited, which constrains the development of nonhydrocarbon industries. Despite this constraint, however, significant progress in diversification has been achieved over the past decade, reflecting the concerted efforts exerted by the authorities. Cooperation with neighboring countries in the Gulf area, through setting up industrial joint ventures, has contributed tangibly to this process.
>
> The strategy for diversification being pursued consists mainly of using the country's ample natural gas resources in industrial joint ventures and creating conditions conducive to the promotion of private sector activity. The largest joint venture so far established is in aluminum smelting. The project has given rise to various other aluminum-based industries, including a large rolling mill. Other projects under construction include production of iron and steel and petrochemicals. A sizable shipbuilding industry has also emerged. Apart from such projects, in which the state directly participates, the authorities have provided various

incentives and infrastructural facilities for stimulating private industrial activity. One of the most significant infrastructural projects, which is expected to open new horizons for economic activity, is the building of a large causeway to Saudi Arabia to be completed by early 1986. As a result of these efforts, and despite adverse developments in the international economy, the manufacturing sector in Bahrain has achieved high growth rates. On the basis of available GDP data for 1977-81, the share of manufacturing and services in GDP appears to have increased notably.

Sustaining the momentum of development in the non-oil sectors has required maintaining public investment expenditure at an adequate level. In the recent past, Bahrain's financial position has not been an important constraint on expenditure growth. Developments in the oil market during the past two years, however, have highlighted uncertainties about the availability of revenues in the future and underlined the need for a more restrained growth of expenditures. Although no serious financial difficulties have yet arisen, the authorities have already taken several fiscal measures in response to these developments. These measures include a substantial revision of the Economic and Social Investment Program. The Program, originally drawn up for four years, has now been stretched out, with reduced allocations, over the six-year period 1982-87. Within the Program, priority is still being given to infrastructural developments. The main projects of the previous Program have been retained, with the period of implementation for some of them extended.

The 1983 budget has also been revised in light of the drop in revenues below the level previously projected. The revised budget recognizes the need to broaden the domestic revenue base. Gasoline prices and tariffs on various items have already been raised significantly and further increases in charges and fees are planned for 1984. On the expenditure side, the level of capital spending has been revised downward, and measures have also been taken to restrain current spending. Taking into consideration likely shortfalls in spending, the staff projects the overall fiscal deficit in 1983 at about 1 percent of GDP. Barring any unexpected extrabudgetary developments, the deficit is considered to be manageable, and its financing is expected to include a new issue of development bonds.

On the monetary side, the high rate of liquidity expansion during 1980-81 was appreciably reduced in 1982. The private sector demand for credit, however, is being adequately accommodated, and the liquidity of banks is being maintained at an appropriate level. Another notable feature has been the continued financial stability in Bahrain at a time of unsettled conditions in other financial markets. The country's monetary authorities have been particularly alert to the dangers of excessive speculative activity in the region. The Bahrain Monetary Agency advised the banks as early as in December 1981 to refrain from discounting postdated checks and again cautioned them in April 1982 against financing speculation in shares and property. To ensure that the legitimate dealings in shares were undertaken in an organized manner, the Agency authorized local banks to take part in providing short-term financing, under conditions established by it, on behalf of individual applications for several new share issues in the first half of 1982.

Such prudence in financial management was necessary not only to ensure the stability of the local market, but also to maintain the reputation of Bahrain as an international financial center. The rapid growth of offshore banking units (OBUs) since 1975 has established Bahrain as a major offshore market, while also contributing to the diversification of activity. The OBUs recorded further growth in 1982, as their number increased from 65 to 72, their total assets by over 16 percent, and their profits by about 42 percent. The contribution of these units to the domestic economy reached 9 percent of GDP in 1981. While the recent international banking situation has, inevitably, had a restraining effect on the growth of OBUs in 1983, these units have now entered a stage where greater emphasis is being placed on consolidation of past growth and diversification of financial services.

In the external sector, the current account, which remains sensitive to changes in the price and output of oil, moved from a deficit in 1978-79 to a surplus in 1980-82. Though the overall account has consistently been in surplus for the past ten years, it, along with the current account surplus, declined in 1982. While prospects for 1983 are still uncertain, some further weakening of the current and overall balance appears likely. The country's reserve position, however, remains relatively comfortable, and, in the medium term, its external balance is expected to improve again with a recovery in the world economy.

Mr. Shaw praised the Bahraini authorities for the skillful and successful way in which the economy had been handled. Despite the gradual depreciation of the major natural resource, the authorities had pursued a policy of economic diversification, with the emphasis on energy-intensive industry using natural gas and energy sources, which amounted to about 50 years' reserves. The focus on international banking indicated foresight by the economic planners.

Another commendable aspect of the economy was the ability of the planners to take quick and decisive action when required, Mr. Shaw continued. As an example, he noted their decision to stretch out the investment program to six years. The authorities were on the right track and deserved encouragement in pursuing the course that they had chosen. Bahrain had regained economic balance in 1980 and 1981 by virtually eliminating inflation and achieving a surplus in the balance of payments.

The authorities had continued that progress in 1982 while increasing reserves to the impressive level of 11 months' non-oil imports, and maintaining a growth rate in the non-oil sector of 14 percent in 1981. Could the staff give some indication of the growth rate in 1982?

In the fiscal area, the authorities had recognized the importance of keeping public expenditures under control, Mr. Shaw commented, but the extrabudgetary expenditures in 1982 were worrying. The extrabudgetary expenditure should be kept within the planned amounts, as those expenditures could make the deficit unmanageable. A large increase could produce inflationary expectations and rekindle inflation.

Monetary policy was appropriate, and he congratulated the Monetary Agency for its foresight with regard to stock speculation in Kuwait, Mr. Shaw stated. The action taken by the authorities in December 1981 in advising banks to refrain from discounting postdated checks was praiseworthy. That timely action could only increase the confidence of the financial community and should ensure the continued excellent reputation that Bahrain enjoyed as a financial center.

In the external sector, the reduction in the overall surplus was substantial, perhaps as a result of a decline in the oil trade, Mr. Shaw said. The authorities should therefore continue to monitor closely the extraordinary expenditures, which could otherwise exacerbate the overall deficit in the balance of payments projected for 1983. Data on the external position of Bahrain were inadequate, and he urged the authorities to make greater efforts to provide data on external developments on a more timely basis. Perhaps technical assistance from the Bureau of Statistics could be considered.

Mr. Suraisry said that he was in general agreement with the staff appraisal. The economy of Bahrain had been adversely affected by recent developments in the international oil market. In 1982 income had been less than in the preceding year, and the balance of payments position had been less satisfactory. However, that unfavorable performance would have been weaker if it had not been for the diversification strategy that had been prevalent for some time. Such a strategy had not only been successful in building large-scale industries but had also been responsible for the emergence of Bahrain as a major financial center, an achievement that increased the contribution of the services sector substantially and consequently lessened the impact of oil development on the economy. He commended the authorities' efforts in that respect, and he expected further diversification of the economy.

The financial position of the country had become less satisfactory in 1982, Mr. Suraisry went on. The authorities had taken commendable measures on both the revenue and expenditure sides, which would have a positive impact on the economic position in general and on the overall financial position in particular. The staff projected that the overall deficit for 1983 would reach 1 percent of GDP, which was not a cause for concern.

The emergence of Bahrain as a major financial center had been a challenge to the monetary authorities, Mr. Suraisry remarked. The rapid growth of the offshore banking units, the size of their operations, their sensitivity to developments in the international financial and capital markets, and their sophisticated financial activities had made the task of the Bahrain Monetary Agency difficult. However, the Monetary Agency had been able to control those factors and to manage monetary policy in a prudent manner, resulting in continued financial stability in Bahrain, unlike what had happened in many other financial markets.

With regard to external sector policies, it was clear that the balance of payments had come under pressure in 1982, Mr. Suraisry remarked. He noted the staff's acknowledgment of an inadequacy in the trade and services accounts data, and he wondered whether the Fund could not consider offering technical assistance in that field. The Fund had provided successful technical assistance in formulating the budget, and further assistance in the balance of payments area could help to eliminate those deficiencies.

The staff representative from the Bureau of Statistics remarked that according to staff estimates, the growth rate had eased in 1982 to 7-8 percent, compared with 9 percent in 1981, reflecting a decline in refinery output. Bahrain had made significant progress in international banking statistics and had assisted the Fund considerably by providing information in connection with the Fund's project on international banking. However, in other areas, particularly trade and balance of payments statistics, the need for improvement in the data base had been acknowledged by the Bahraini authorities. A technical assistance mission would visit Bahrain later in 1983 to help the authorities to remove some of those data gaps.

Mr. Finaish thanked those who spoke for their contributions and said that he would convey their remarks to his authorities.

The Acting Chairman made the following summing up:

> Directors who spoke indicated general agreement with the staff appraisal. They commended the authorities for their continuing and successful efforts to broaden Bahrain's economic base by establishing, in cooperation with neighboring countries, large-scale, exportoriented industrial enterprises and by developing Bahrain into a major regional services center, especially in the financial sphere. In the latter connection, the actions of the Bahrain Monetary Agency were commended. The diversification effort has been of particular importance for Bahrain, whose crude oil output is small and has been declining for several years. Directors noted that in the recent past satisfactory economic growth had been achieved without pressures on prices and resources. The fiscal and external positions had, however, weakened somewhat after 1981, reflecting mainly the changed oil market situation.

Directors commended the prompt steps being taken by the Bahrain authorities to ensure that the Government's financing requirements do not outstrip available resources. They referred in this connection to the stretching out of the Government's investment program from four to six years, the curbing of current expenditures, and the increases in fees and charges. Directors observed that economic management would be facilitated by further improvement in domestic and external economic statistics in Bahrain.

Directors expressed the view that in the short run the balance of payments was likely to weaken further, mainly because of lower earnings from the oil sector. However, they did not believe that there was any reason to consider a change in external policies, given the relatively comfortable foreign reserve position and the low level of external debt service payments, as well as the promising outlook in the medium term for increased earnings from non-oil exports and the services sector.

It is expected that the next Article IV consultation with Bahrain will be held on an 18-month cycle.

APPROVED: March 15, 1984

LEO VAN HOUTVEN
Secretary