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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/147

10:00 a.m., October 5, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| A. Alfidja | L. K. Doe, Temporary |
| | G. Ercel, Temporary |
| | X. Blandin |
| | C. A. Salinas, Temporary |
| R. D. Erb | |
| | S. R. Abiad, Temporary |
| | T. Yamashita |
| J. E. Ismael | |
| R. K. Joyce | L. Leonard |
| | C. Robalino |
| G. Laske | |
| G. Lovato | C. P. Caranicas |
| R. N. Malhotra | |
| | S. El-Khouri, Temporary |
| J. J. Polak | |
| | K. G. Morrell |
| G. Salehkhou | O. Kabbaj |
| F. Sangare | E. I. M. Mtei |
| M. A. Senior | |
| J. Tvedt | |
| | A. Clark |
| | Wang E. |

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

African Department: J. J. Zulu, Director; R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; A. Basu, E. L. Bornemann, J. F. Briffaux, E. A. Calamitsis, C. V. Callendar, F. d'A. Collings, A. B. Diao, A. Doize, K. G. Dublin, E. Enweze, C. J. Hoban, J. Kakoza, M. G. Kuhn, D. J. Scheuer, M. Sidibe. Central Banking Department: P. Ewenczyk. Exchange and Trade Relations Department: M. Guitian, S. Kanesa-Thasan, A. K. Mitchell. Fiscal Affairs Department: M. J. Fetherston. Legal Department: A. O. Liuksila, J. M. Ogoola, S. A. Silard. Research Department: K.-Y. Chu, N. M. Kaibni, A. Salehizadeh, H. H. Zee. Western Hemisphere Department: H. Wiesner, Director; S. T. Beza, Associate Director; M. Caiola, L. A. Cardemil, C. Cha, H. R. DeZoysa, J. Ferrán, M. T. Hernandez, T. F. Lehwing. Bureau of Statistics: K. Yao. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, J. R. N. Almeida, C. J. Batliwalla, T. A. Connors, S. E. Conrado, K. A. Hansen, W. Moerke. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. Bulloch, M. Camara, M. Eran, C. Flamant, V. Govindarajan, N. U. Haque, C. M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, J. A. K. Munthali, E. Portas, M. Rasyid, J. Schuijer, D. I. S. Shaw, N. Toe, J. C. Williams.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Luke Leonard on taking up his position as Alternate Executive Director to Mr. Joyce.

2. NIGER - STAND-BY ARRANGEMENT, AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered requests from Niger for a stand-by arrangement for a period of 14 months in an amount equivalent to SDR 18 million (EBS/83/194, 9/7/83) and for a purchase equivalent to SDR 12 million under the compensatory financing facility (EBS/83/195, 9/9/83; and Sup. 1, 9/30/83).

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

> I would like to provide information on recent policy measures that the Niger authorities have taken to facilitate the implementation of the financial program described in EBS/83/194 dated September 7, 1983.
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> The Government has decided to eliminate all the urban sales centers of the official food marketing enterprise OPVN and progressively to reduce the number of rural sales outlets. The OPVN's pool of vehicles has been reduced by 50 percent, and it will be relying more on private trucking services. Official procurement of millet and sorghum will be limited to 20,000 tons in 1983/84 compared with 80,000 tons in 1982/83, so that a sizable part of future sales will be made by reducing the existing high level of cereal stocks. With these steps, the OPVN is expected to improve its financial situation substantially in 1983/84. As to the other major official marketing agency COPRO-NIGER, the Government has abolished its monopoly rights to imports of condensed milk, tomato paste, flour, sugar, and fabrics. The Government has also adopted flexible pricing policies for the other consumer products marketed by COPRO-NIGER to permit it to raise its trading profit margins. The requirement of maintaining security stocks equivalent to three months' consumption has been abolished.
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> The structure and level of the tariffs of the electricity company NIGELEC have been revised, to raise tariffs by an average of about 21 percent. There will be put in place a mechanism that will permit tariffs to be adjusted in the future in accordance with an appropriate index of production costs.
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> A two-year bilateral technical assistance program to improve the management of the state-owned coal plant SONICHAR has begun. The Niger authorities have already contacted

SONICHAR's bilateral and multilateral foreign creditors to seek a rescheduling of the coal plant's foreign debt. The final negotiations of SONICHAR's debt and an overhaul of its electricity tariffs are expected to take place after the Paris Club meeting scheduled for end-November 1983.

A total of seven studies have been completed, one each for the OPVN, COPRO-NIGER, SONICHAR, NIGELEC, the two financial institutions (BRRN and CNCA), and the water resource agency (OFEDES). The authorities are reviewing these studies to decide on further measures to be taken in the future.

The official 1983/84 budget has a revenue target of CFAF 78.5 billion compared with a program target of CFAF 76 billion. All the tax measures described in the program have been taken, and the authorities have indicated that they believe that the higher revenue figure can be achieved because the revenue collection procedures have been strengthened and the measures to increase taxation have been implemented well in advance of the beginning of the fiscal year. Total expenditure--including current outlays, local currency contributions to investment projects, and all debt service payments net of expected debt relief--has been budgeted at CFAF 78.5 billion, subject to the understanding that the planned level of CFAF 76 billion will not be exceeded if the additional revenue gain is not realized. Also, steps have been taken to ensure that the programmed level of investment expenditure financed by foreign loans, totalling CFAF 30.4 billion, will be in accordance with the investment program presented in EBS/83/194.

The Government has also reached agreement with its domestic creditors regarding the repayment of domestic arrears in line with the timetable for reducing such arrears under the proposed program.

Mr. Alfidja recalled that on July 1, 1983, at EBM/83/96, the Executive Board had had an opportunity to review the economic performance of Niger during the past few years. Since then, the Fund management had reached an agreement with the authorities in Niger for a 14-month stand-by arrangement in an amount of SDR 18 million or 75 percent of quota, involving no use of borrowed resources.

As he had said at EBM/83/96, Mr. Alfidja went on, serious economic and financial imbalances had emerged in the economy of Niger in recent years, largely as the result of pronounced fluctuations in the price and demand for uranium. Indeed, real GDP had contracted in 1982, following two years of a steady slowdown in activity. In the same year, export receipts had fallen by 19 percent, following a 10 percent deceleration in the preceding year. Major cutbacks had been carried out in imports. The overall budget deficit had exceeded the equivalent of 6 percent of GDP each year from 1980 to 1982, while domestic credit

had expanded at an average rate of some 31 percent a year. The external debt service ratio had also deteriorated markedly. Following a period of relatively moderate movements in the overall foreign balance, the deficit had reached SDR 119 million in 1982.

In an attempt to restore the viability of the economy, Mr. Alfidja noted, the Government of Niger had undertaken a medium-term economic program for 1983-87. Among other objectives, his authorities were aiming at reaching self-sufficiency in food production and at improving the productive apparatus of the country. As he had mentioned in July, those objectives were to be achieved by a combination of policies, including a more flexible pricing policy on agricultural products and the reorientation of capital expenditure toward the directly productive sectors. It was as part of the medium-term adjustment effort that the Government had begun to implement a financial program in support of which it had requested the present stand-by arrangement.

The focus of the stabilization program was a reduction in the financial imbalance in the public sector, Mr. Alfidja explained. In particular, the overall budget deficit of the Central Government was expected to decline from an estimated 6.2 percent of GDP in 1982/83 to 3.4 percent a year later following the adoption of measures aimed at restraining expenditure growth and increasing revenue. In anticipation of the program, the Government had already introduced a number of measures, such as freezing salaries, limiting the hiring of part-time workers, reducing the use of government vehicles, and cutting back on capital expenditure. On the revenue side, the revenue-strengthening measures introduced as part of the budget for fiscal 1982/83 had been strengthened by the early introduction of an additional tax package forming part of the present program. The early enactment of those measures was an indication of his authorities' resolve to restore the fiscal balance. As noted by the staff, the effect of those measures was likely to be slightly more revenue than had been expected for 1983/84. The program would also help to improve tax administration. Most of the changes were in line with recommendations made by a Fund technical assistance mission.

The determination of his authorities to restore viability in the real and financial sectors of the economy was shown by the steps that they had taken toward revitalizing and improving the financial performance of the public enterprises, Mr. Alfidja considered. The Government intended to examine closely the recommendations of the studies dealing with the financial situation of the main public enterprises, and to take the relevant measures when necessary.

As for public debt, the Government had reached agreement with its domestic creditors and planned to eliminate domestic arrears within 3-4 years, Mr. Alfidja recalled. The Government would seek to negotiate debt relief arrangements with its foreign creditors fairly soon. Meanwhile, it had approached the World Bank and the Fund for technical assistance in order to strengthen its debt management procedures.

His authorities believed that, as a result of the more prudent fiscal and monetary policies recently adopted, the imbalances in the external accounts would be reduced, Mr. Alfidja noted. In particular, the cutbacks in the public sector investment program, the rise in customs duties, and the improvement in consumption and income taxes would lead to a significant decline in imports, and hence to a marked improvement in the current and overall accounts of the balance of payments. Naturally, the expected improvement in the outturn of the overall balance was conditional upon the conclusion of favorable external debt relief arrangements. He hoped that the foreign creditors concerned would give the country the recognition that it deserved as a result of the adjustment efforts made, and heed the Government's call for rescheduling of the country's debt.

Following the Executive Board's discussion on July 1, Mr. Alfidja remarked, the authorities had made a purchase of SDR 12 million under the compensatory financing facility, equivalent to 50 percent of quota. The authorities had now asked for an additional purchase of SDR 12 million under the compensatory financing facility, together with SDR 18 million under a stand-by arrangement. The two requests under the compensatory financing facility were in compensation for large shortfalls in export earnings, due mainly to fluctuations in the price of and demand for uranium. Niger's request had met all the criteria under the compensatory financing decision, and it deserved the support of the Executive Board.

Mr. Sangare said that he would support Niger's requests both for the use of Fund resources under the stand-by arrangement and for a purchase under the compensatory financing facility. The staff papers not only gave a clear description of the problems confronting Niger; they also gave valuable information on the measures that the authorities had either put in place or intended to adopt by September 30, 1984. The measures were sufficiently strong to achieve the objectives laid out in the program.

The staff had made it abundantly clear, Mr. Sangare considered, that Niger's economic problems had arisen mainly from an overdependence on one export commodity--uranium--which accounted for more than 80 percent of the country's export earnings, and the continued weakening of world demand for that commodity. The resulting shrinkage in government revenue, the reduction in foreign exchange earnings, and the accumulation of a large current account deficit had been compounded by the fact that Niger was landlocked and suffered from weak financial management, mounting external indebtedness, and an unprofitable public sector. Nevertheless, despite an increase in the debt service ratio from under 14 percent in 1979 to almost 36 percent in 1982, Niger had not defaulted on any of its external payments obligations, although it had incurred external payments arrears, together with a sizable amount of domestic arrears.

In the circumstances, Mr. Sangare remarked, if the stabilization program was to succeed, the authorities would have to aim in particular at reducing both domestic and external imbalances. The major elements of the program--a substantial reduction in public sector expenditure, an increase in efforts to raise non-uranium-based revenue, and appropriate reforms in the public sector enterprises--were appropriate. It was clear that the needed adjustment could not be carried out during the period covered by the stand-by arrangement; it would need to run at least into the medium term. Consequently, the investment policies and production incentives embodied in the program should be geared toward broadening the productive base of the economy and diversifying the country's exports. The targets contained in the program seemed to be both feasible and realistic in the circumstances of Niger. The authorities would however have to devote themselves with energy and perseverance to implementing the measures spelled out in their memorandum on the country's economic and financial policy (Appendix to EBS/83/194).

The success of the program also hinged on the support of the international community, Mr. Sangare emphasized. The course of developments outside Niger, over which the authorities had little or no control, would also be crucial. The importance of debt relief combined with rescheduling on favorable and appropriate terms could hardly be overemphasized. Despite a substantial reduction in imports, which had led to a narrowing of the current account deficit, the overall balance of payments deficit had been increasing in line with a decline in capital inflows. Although the authorities would take action to stimulate capital inflows, what was required was a concerted effort by the capital exporting countries. Interest rate developments in the international financial centers were also bound to have a major effect on Niger's debt service burden. Similarly, developments in international currency markets would have an impact. The staff had correctly noted in EBS/83/194 that the contract price of uranium, which was set in CFA francs, had failed to rise in line with the depreciation of the CFA franc against the U.S. dollar, while the cost of debt service denominated in dollars had increased. He could not see how the authorities could substantially raise agricultural producer prices because of the depreciation of the CFA franc, unless the export prices of such stocks were denominated in dollars, not in French francs or CFA francs. It would be interesting to know what proportion of Niger's agricultural exports were denominated in dollars.

As to the request for a purchase under the compensatory financing facility, Mr. Sangare continued, Niger's balance of payments need had been demonstrated beyond doubt. The shortfall in export earnings had been attributed largely to the fall in the value of exports of uranium, but it was also due to a decline in other exports including those of livestock and livestock products. The factors responsible for the shortfall had been shown by the staff to be beyond the control of the authorities. With the recovery of economic activity now under way in the industrial countries, the world demand for Niger's exports would

certainly improve. He could therefore agree with the staff that the shortfall would be temporary and reversible. The staff had stated that the stricter test of cooperation was amply met by the economic and financial stabilization program described in EBS/83/194. He could therefore support the two requests.

Mr. Blandin remarked that he had no reservations about supporting the two requests under consideration. He was not disturbed by the request for a waiver of the six-month limit on estimated exports in connection with the requested purchase equivalent to SDR 12 million under the compensatory financing facility. The request appeared justified on purely technical grounds. Moreover, the staff had made it clear that all the usual requirements for a purchase under the compensatory financing facility had been met, including the stricter test of cooperation with the Fund, since the stand-by arrangement, which--he was sure--the Executive Board would shortly approve, was supporting a strong adjustment program.

Apart from the weakening of demand for uranium, which had clearly been beyond the control of the authorities, Mr. Blandin went on, the main cause of Niger's present difficulties had been the uncontrolled increase in extrabudgetary expenditures, mostly for infrastructure projects that were not directly productive and had sometimes been inappropriately financed. The program rightly addressed that problem, since the bulk of the adjustment effort was to be on the fiscal side. The authorities had done well not to await the adoption of the program before taking a number of steps that had already helped to reduce the government deficit during fiscal 1982/83. He had also been impressed by a number of the measures in the 1983/84 budget that had already been implemented.

The efforts undertaken by the authorities in Niger were really very great, Mr. Blandin considered. They were intended to reduce the government deficit by 3 percentage points of GDP in fiscal 1983/84 alone to 3.4 percent of GDP. Together with the necessary restraint on credit expansion, the fiscal effort would reduce the external current account deficit from 11 percent to 7 percent of GDP. In view of the strong effort, he wondered why the Fund had limited the amount of the stand-by arrangement to 75 percent of quota and the period to 14 months. He was the more surprised because a financing gap of CFAF 10 billion would have to be filled partly by obtaining the assistance of the Paris Club and partly by rescheduling the debt of SONICHAR. It should not be impossible to obtain the rescheduling since the amount of debt relief assumed by the staff represented less than 50 percent of the debt service payments eligible for rescheduling through the Paris Club. But he wondered whether it would not have been cheaper for Niger to draw additional Fund resources instead of requesting the rescheduling. Similarly, he had noted that Niger would be entitled to use the counterpart of Fund drawings up to CFAF 6.7 billion, representing the SDR 18 million under the stand-by arrangement. There again, he wondered whether it would not have been appropriate to authorize the authorities to use the

counterpart of the SDR 12 million drawing under the compensatory financing facility, which would have allowed internal arrears to have been reduced by about another CFAF 5 billion.

The forthcoming mid-term review could provide a good opportunity to review the matter, Mr. Blandin concluded, especially as at that time the final appraisal of the export shortfall for 1983 would be available. The review would also be a good opportunity for assessing the public investment plan being devised with the assistance of the World Bank. Once that was available, Executive Directors would have a better idea of the medium-term prospects for Niger.

Mr. Laske commented that he was satisfied that Niger had met the test of cooperation required for a drawing under the compensatory financing facility representing more than 50 percent of quota. Nevertheless, the initial disbursements under the requested stand-by arrangement and the purchase under the compensatory financing facility, together with the purchase under the compensatory financing facility made in July 1983, would provide financial resources to Niger that were in excess of the overall balance of payments deficit projected for FY 1982/83. The excess was to be used to strengthen the external position of the commercial banks, a use that might well be appropriate in view of the heavy short-term foreign borrowing that the banks had engaged in in recent years.

Although the current account deficit was forecast to decline substantially in 1984 from the present high level, Mr. Laske noted, the overall balance of payments deficit would rise still further. Financing was expected to take the form of a relatively large amount of debt relief, accompanied by a further reduction in official assets held abroad. The balance of payments position was extremely fragile, a situation that had been brought about partly by the large increase in government expenditures since 1979, partly by excessive dependence on mining exports, and partly by the large debt service burden resulting from excessive foreign borrowing, particularly on commercial terms.

The authorities had started to take a number of adjustment measures in 1982, aimed primarily at scaling back their investment plans to a more appropriate level, Mr. Laske observed. It was valuable that, in contrast to past practice, no investments were being undertaken that did not have a directly beneficial impact on the country's productive capacity and the balance of payments position. The debt service burden was an even more serious component of the precarious external situation than the cloudy outlook for uranium. Without the envisaged debt relief, it was likely to become unmanageable. Severe restraint in further current foreign borrowing on commercial terms was therefore strongly advised.

The measures adopted by the authorities were also intended to bring about savings in the Government's current expenditure and to improve both the operations and the financial position of the public

sector enterprises, Mr. Laske noted. He welcomed the action recently taken by the authorities to improve the operations of the marketing organizations and to restructure the tariffs of the utility company. Nevertheless, those were only first steps; he hoped that the studies undertaken with the help of outside technical assistance would be converted into specific action as speedily as possible. Otherwise, the budget relief expected to arise from an improvement in the operation of the public sector enterprises might not occur. Current government expenditure as a whole was expected to rise by only 4 per cent in fiscal 1983/84, a laudable objective, particularly as it would involve a decline in real terms. A slowdown in monetary expansion was expected to follow the achievement of the fiscal target.

The uncertainty of the outlook for Niger was reflected in the fact that precise performance criteria had been set only for the first four months of the program period, Mr. Laske remarked. The criteria for the following three quarters were to be set during a review in January 1984. The procedure was prudent in the circumstances, and he hoped that by January 1984 the authorities would have introduced the necessary measures to reach their targets for the 1983/84 budget. If developments should be less favorable than envisaged, the authorities should be prepared to take another look at their investment plan. Unfortunately, it might be easier to make savings in investment than in current expenditure.

As to the request for a drawing under the compensatory financing facility, Mr. Laske noted that the data for non-uranium exports had been estimated for the entire shortfall year, and that the Executive Directors were asked to permit a departure from the provisions on that point in the decision on the compensatory financing facility. Such a waiver had been granted only once before, and, in earlier policy discussions on the compensatory financing facility, he had advocated shortening the period for which estimated data could be used. He hoped that the lengthening of the estimation period in the present instance would remain a rare exception and would on no account be taken as a precedent. He could agree to the proposed waiver only because non-uranium exports constituted only a small part of total exports from Niger, and because the shortfall calculated for the uranium exports was considerably larger than the drawing requested under the compensatory financing facility. He could support the two proposed decisions.

Mr. Ismael said that he supported both the proposed stand-by arrangement and the purchase under the compensatory financing facility. The amounts involved were small and rather modest compared both to Niger's quota and to the export shortfall. The financial program that the authorities intended to undertake was quite strong, and the request for a purchase under the compensatory financing facility met the criteria for a drawing over 50 percent of quota. The authorities were moving in the right direction toward restoring viable balances both in their fiscal affairs and in their external accounts. They were, however, certainly facing a major dilemma. As their intention was to achieve a more balanced growth pattern, they needed to diversify the economy away from the present

heavy reliance on uranium exports, which accounted for three quarters of Niger's total export receipts. They would therefore require large investments, and consequently imports of capital goods. On the other hand, the present financial constraint had forced the authorities severely to cut back such investment, thus delaying the diversification process. He hoped that the staff would adequately take the situation into account in designing the stand-by program.

Mr. Abiad remarked that the economic and financial problems facing Niger remained as difficult as they had been at the time when the Executive Board had completed the consultation with Niger at EBM/83/96. The staff had made clear in EBS/83/194 that the authorities had begun to shift their policies toward effective financial restraint earlier in 1983: they had taken measures to raise tax revenues and reduce public expenditures. Their having taken actions of that sort in anticipation of the program to be supported by the Fund stand-by arrangement was indicative of their commitment to the adjustment process.

The program under consideration, Mr. Abiad went on, envisaged a number of further adjustment measures affecting both demand management and the supply side, and involving, among other things, a reordering of public investment priorities and the reform of public sector enterprises. Although they entailed certain costs, particularly in terms of economic growth in the short and medium term, such measures were clearly warranted by the country's economic and financial circumstances, as well as by the external environment. The performance criteria attached to the proposed program seemed to be broadly appropriate. Observance of the criterion relating to the reduction of the Government's arrears vis-à-vis local enterprises and banks would be essential both to bring about the restoration of domestic economic activity and to enhance confidence abroad in the country's economic management. He noted that the accumulation of external public payments arrears had so far been avoided; it was important to maintain that position in the period ahead. In those circumstances, the Government's intention to strengthen its external debt management was welcome.

As to the external accounts, Mr. Abiad observed that the staff considered that, after a small decline in 1983, exports would rise in 1984 by only 6 percent above the 1982 level, mainly on account of higher uranium exports. It would be useful if the staff could indicate the assumptions underlying the expected increase in the value of uranium exports, particularly in relation to the outlook for world demand for various energy sources.

In brief, Mr. Abiad concluded, if the measures envisaged by the authorities were fully implemented, the program--which the staff had described as well balanced and consistent with the objectives to be achieved during 1983/84--would constitute an important step in Niger's adjustment, a step that would deserve the Fund's full support. Executive Directors would recall that in its latest communiqué the Interim

Committee had emphasized that the Fund should be particularly mindful of the difficult circumstances of small-quota, low-income member countries such as Niger. His chair had no difficulty in supporting the proposed decisions covering the stand-by arrangement and the request for a drawing under the compensatory financing facility.

Mr. El-Khouri observed that during the past two years Niger had experienced growing economic and financial imbalances, due mainly to external factors beyond the authorities' control. Nevertheless, domestic policies had also contributed to the deterioration of the economic situation. The authorities had responded to the difficulties by adopting a strong adjustment program, in support of which they were requesting a stand-by arrangement with the Fund. He commended the authorities on their adjustment effort and supported their request.

A number of measures had already been taken to strengthen the financial position of the Central Government as well as of the public enterprises, Mr. El-Khouri remarked. On the government side, the actions had included a package of tax reform measures, restraint of current expenditure, and a reduction in investment expenditure. As a result, the budget deficit was expected to decline substantially in 1983/84. The comprehensive study undertaken with the help of the World Bank to determine ways in which the public enterprise sector could be strengthened was welcome. Furthermore, the adjustments made in the pricing policies of a number of enterprises should help to strengthen their financial position. He welcomed the additional information provided by the staff regarding the progress made in the public enterprise sector.

No external arrears had been incurred despite the substantial worsening of Niger's foreign payments position during the past two years, Mr. El-Khouri noted. That achievement should help Niger to obtain a rescheduling of its debts to the Paris Club members and commercial banks on favorable terms. As to the details of rescheduling, he did not understand how the staff had arrived at the figure of SDR 24.4 million for debt relief. Similarly, it would have been helpful if the staff had explained more clearly how it had calculated the amount of balance of payments financing to be provided by the Fund.

Indicative ceilings had been suggested by the staff for the last three quarters of the program period, with specific performance criteria for those periods to be established during the review to be held in January 1984, Mr. El-Khouri observed. In view of the uncertainties involved, he could accept the specification of performance criteria for only the first quarter of the program period. Nevertheless, programs should in general attempt to specify performance criteria for at least six monthly periods in order to give a firmer direction to country policies.

As to the request for a purchase under the compensatory financing facility, Mr. El-Khouri said that it was clear that the request met all the requirements under the compensatory financing decision, and that he would therefore support it. Moreover, he could go along with the staff recommendation for a waiver of the six-month limit on estimated exports, for the reasons set out on page 3 of EBS/83/195.

Mr. Joyce remarked that he was well aware, as other speakers clearly were also, of the difficult problems facing Niger both in the immediate future and in the medium term. The authorities had little room for maneuver in view of the country's dependence on uranium exports, and yet they recognized the need for fundamental adjustments in government policy. He welcomed the measures already taken and the authorities' intention to pursue those measures over the coming months.

As the staff had pointed out, Mr. Joyce continued, part of the problems in Niger had arisen from the imbalances in the operations of the Government and the public sector enterprises. Nevertheless, the authorities had taken substantial steps, particularly in the fiscal area, where they were implementing a comprehensive tax reform after introducing additional tax measures and setting themselves courageous targets for cutbacks in expenditure. He also welcomed the information provided by the staff regarding the actions taken to control the public sector enterprises and reorganize their activities. He was impressed not only by the decision to increase the prices charged by parastatals to consumers but also by the significant increases that had taken place in agricultural producer prices over the past two years. The measures taken to correct the balance of payments disequilibria were also to be welcomed. The taxation of imports could certainly make an important contribution to bringing the external payments into balance, but a satisfactory outcome would also depend upon the continued deceleration of domestic credit expansion, a cutback in budgeted investment, and of success of import substitution in the agricultural field. Nevertheless, taken all in all, the authorities seemed to be doing well in the short term.

Like Mr. Ismael, Mr. Joyce went on, he was more worried about the medium term. For the immediate future, the authorities had no option but to try to shift the emphasis in the investment program toward agriculture and transportation. They would also have to cut back on the public investment program, simply on the grounds that the country could not afford any more extensive investment, in view of the decline in the country's revenues and the excesses of previous expansionary programs. On the other hand, in the medium term, Niger would certainly have to diversify; he therefore attached particular importance to the World Bank review of the investment program. Indeed, he hoped that the review would be available by the time of the Fund's mid-term review of the stand-by arrangement that was to take place in January 1984.

Another of the main difficulties facing Niger was the debt service burden, Mr. Joyce commented. If the program was to be at all successful, a considerable degree of debt rescheduling, particularly in the Paris Club, would be necessary. Like Mr. Blandin, he was not quite clear why the proposed debt rescheduling was not more extensive. For instance, projected relief for 1984 was put in the neighborhood of SDR 24.4 million, compared with a total debt service for 1984 of SDR 95.5 million. In any event, he was glad that the Government had committed itself not to engage in further borrowing except on concessional terms, and also that steps had been taken in the Finance Ministry to strengthen debt management.

He had no hesitation in supporting the program, Mr. Joyce stated. Indeed, he was glad that it was a one-year program, in view of the uncertainties that lay ahead. It also made sense only to establish performance criteria for the first quarter of the program, leaving criteria for later months to the mid-term review in January 1984.

It seemed evident, Mr. Joyce continued, that Niger would have to return to the Fund after the conclusion of the program. However, if a firm base could be established during 1983/84, combining debt rescheduling with Fund financing, Niger might be able to position itself for a firmly based development effort with the prospect that it could attain a sustainable balance of payments position in a reasonably short time.

As to the request for a purchase under the compensatory financing facility, Mr. Joyce noted that the proposed waiver would represent a break with tradition. However, while like Mr. Laske he was hesitant about creating precedents, in the particular instance of Niger a waiver was justified, especially as the 12-month estimate applied to only a rather small component of the country's export performance.

Mr. Malhotra stated that his chair supported both of Niger's requests.

Mr. Polak commented that some of his observations would be similar to those by Mr. Ismael and Mr. Joyce. The program put forward by the staff was a good financial program from the Fund's standpoint, meaning that it addressed the short-run causes of Niger's financial difficulties: government expenditure and related aspects had got out of hand and needed correcting. The intention to halve the fiscal deficit in one year was certainly commendable, and the authorities had introduced substantial measures, including cuts in government investment, major changes in the public sector enterprises, and the like.

What he missed, Mr. Polak continued, was any idea for a satisfactory factory long-term solution to the problems in Niger. The terms of trade had been deteriorating for a number of years and were expected to continue to do so. Niger was largely dependent on exports of uranium,

for which the future was not particularly cheerful. An increase in export earnings of at least 5 percent a year, together with an increase in transfers, was needed for no other purpose than to reduce the external debt service ratio to a reasonable figure. The forecast of export growth for 1984 and 1985 contained in EBS/83/195 was not very strongly backed by the evidence. The export growth was expected to come entirely from a rise in the price of uranium, other products remaining stagnant. If in fact Niger was to gain 5 percent a year--perhaps equivalent to the world inflation rate--up to 1990, it could not rely on uranium alone. What was needed was diversification. There were some indications of an investment program supported by the World Bank intended for that purpose, but the description was relatively brief. In the circumstances, not only the Fund but also the World Bank--perhaps particularly the World Bank--ought to concentrate heavily on what could be done to raise Niger's exports in the medium term.

The staff had remarked that the exchange rate was not relevant to Niger's problems, Mr. Polak noted. No reference had been made to the exchange rate for the CFA franc, but the French franc had, in falling vis-à-vis the U.S. dollar, made it possible to raise producer prices in Niger. Even though the staff had reported that the prices paid for exports in Niger were still lower than those that the farmers themselves could obtain, the subject was a most important one that ought to be pursued further in collaboration with the Niger authorities.

Regarding the request for a purchase under the compensatory financing facility, Mr. Polak stated that it seemed entirely reasonable to him that the Fund should show some degree of flexibility for a small country that did not have monthly statistics for all its exports, for the specific reasons mentioned by the staff. Nevertheless, the language of the proposed decision ought to reflect the situation better than it actually did. He would make a proposal when Executive Directors turned to the decision at the end of the discussion.

Mr. Morrell stated that he generally agreed with the staff appraisal, and that he supported the proposed decisions relating to the stand-by arrangement and the purchase under the compensatory financing facility. The major part of the deterioration in Niger's external position since 1981 had been brought on by the weak demand for uranium, on which Niger depended for three quarters of its export earnings, and which explained three quarters of the calculated export shortfall. Clearly, the country needed to diversify its export base, but diversification would require large capital inflows, which would certainly be difficult to achieve because the dependence on uranium limited the ability of the economy to generate resources when markets were weak. Growth in the fiscal deficit had thus contributed to the external imbalance, since the authorities had found themselves unable to finance their investment outlays while providing for the heavy debt service and the unproductive operations of the public sector enterprises. The

program under consideration should therefore focus on improving the fiscal sector, as the authorities had understood by undertaking to reduce the fiscal deficit to 3.4 percent of GDP in 1983/84.

He could endorse the measures to increase revenues during the program period, particularly the proposals to raise half the increase from adjustments to direct taxes, Mr. Morrell said. He also welcomed the authorities' intention to eliminate domestic arrears in three or four years, although the time might seem fairly long. Cutting expenditure was probably unavoidable as part of the action to improve fiscal performance; but he did recognize that a large cut in the capital account could have the effect of hampering progress toward the diversification and the structural transformation of the economy, particularly for the export sector, that was so badly needed. The structural transformation would require not only augmenting the capital stock but also improving the efficiency with which the existing stock was used. He therefore welcomed the efforts of the authorities to improve the operations of what appeared to be a large public enterprise sector through a broad range of measures, including the scaling down of operations, cutting the cost of overhead, and introducing appropriate pricing policies. The enterprise-by-enterprise approach in close cooperation with the World Bank made him confident that the reform was proceeding in the right direction.

The program of credit restraint outlined by the staff was consistent and supported the fiscal stance, Mr. Morrell concluded. Although he could understand Mr. Sangare's argument about the effect of pricing Niger's exports in CFA francs on the ground that most of the exports went to France, he wondered whether the authorities could not hedge their export earnings by pricing in other currencies. In conclusion, he could support the purchase under the compensatory financing facility and the waiver of the six-month limitation on the use of estimated data, because the relevant export sector was fairly small.

Mr. Salehkhou commented that during the past two years Niger's economic performance had been adversely affected by the international deterioration of the markets for uranium, which represented 80 percent of the country's total export earnings. It had also been affected by the decline in aid flows for 1982, an unfavorable agricultural harvest, and a deteriorating debt situation. The sharp deterioration in Niger's terms of trade for 1981 and 1982 had clearly contributed to the creation of large unsustainable domestic and external imbalances. Exports had declined by 80 percent in 1982, and the current account deficit had reached 14 percent of GDP, while external debt had reached some 50 percent of GDP and the budget deficit 10 percent of GDP. The situation had also been characterized by substantial inflationary pressures.

In concluding the 1983 Article IV consultation with Niger in July 1983 (EBM/83/96), Mr. Salehkhou recalled, many Executive Directors had welcomed the authorities' intention to implement a broader and stronger adjustment program and to seek Fund assistance, in addition to the

significant measures that they had taken earlier in the year. Some of those Executive Directors had also expressed the hope that, in view of Niger's medium-term prospects and of the low Fund holdings of the CFA francs of Niger in terms of quota, cooperation with the Fund could take the form of an extended arrangement. He would therefore appreciate hearing more from the staff as to why it had preferred a shorter-term arrangement, despite the scope of many of the measures taken by the authorities which would extend into 1985. In any event, it had encouraged him to note that the authorities were implementing a program that was to a large extent in line with the recommendations put forward by Executive Directors at EBM/83/96. Considering the structure of Niger's economy, the program focused appropriately on fiscal policy and on the need to significantly improve public finances, including those of the large public enterprise sector.

While the impressive list of fiscal measures envisaged under the program, including a set of tax measures and significant cuts in public investment expenditure, should result in a substantial reduction of the overall fiscal deficit by the end of 1983/84, Mr. Salehkhou observed, they should also help to achieve a significant improvement in the external current account deficit. Pressure on the external accounts would also be alleviated through the sharp deceleration in domestic credit expansion, the stricter control of extrabudgetary outlays, and the stronger financial situation of the public sector enterprises that was likely to appear as a result of the reforms.

The additional information provided by the staff and amplified in Mr. Alfidja's statement clearly indicated that the authorities were serious in their attempts to implement the program under the requested stand-by arrangement, Mr. Salehkhou considered. He had been particularly pleased to see that the authorities had taken a number of measures aimed at streamlining the public enterprises, largely in line with the World Bank recommendations, and that further measures were to be taken in the future.

The case for a purchase of more than 50 percent of quota under the compensatory financing facility had been clearly established, Mr. Salehkhou commented, as had the case for adopting a waiver of the six-month limit on estimated exports. He therefore supported not only the proposed stand-by arrangement but also the purchase under the compensatory financing facility.

Mr. Wang stated that his chair supported the proposed decisions both for a stand-by arrangement and for a purchase under the compensatory financing facility.

Mr. Erb said that he could support both the request for a stand-by arrangement and that for a purchase under the compensatory financing facility. The staff had appropriately designed the Fund's commitment, namely, 75 percent of quota over a 14-month period, despite the uncertainties about the timing and extent of the adjustment in Niger's

external balance of payments position. Even when the temporary shortfall was reversed, Niger would have a continuing balance of payments adjustment problem, and he was glad to see that that adjustment would be dealt with in a medium-term context at the time of the mid-term review.

In the early stages of adjustment, it was appropriate for the authorities to focus their efforts on reducing the large deficit in the public sector enterprises and on bringing down the fiscal deficit, Mr. Erb went on. He commended the authorities for the efforts that they had made, and he agreed with Mr. Polak that it was appropriate for the Fund to commit its resources despite the uncertainty about when a sustainable balance of payments position would be achieved. He would not wish to prejudge the future role of Fund financing after the completion of the current stand-by arrangement. On the other hand, he would certainly wish to examine the medium-term analysis and to review the prospects for the investment program in the light of the World Bank's comments. He could support the request for a purchase under the compensatory financing facility and that for a waiver of the six-month limit on export estimations. Like Mr. Laske, he believed that only in rare exceptions should the Fund grant a waiver from the estimation of exports for the full 12-month period. However, as the estimated part of the exports represented such a small proportion of the total, he could see no objection in the present case.

The staff representative from the African Department explained that the staff would make a complete assessment of the medium-term outlook for Niger during the early part of November 1983, when a mission was expected to visit Niamey. That mission would be a joint one with the World Bank and would look into the two-year investment program to end in 1985. It was difficult to try to formulate longer-term plans at the present time because of the existing financial constraints and the uncertainty about future aid flows. Nevertheless, for the two-year period, the mission would try to assess the availability of financing, the quality of the investments, and the internal financing constraints. The latter was an important point because, if the local currency counterpart of foreign loans were not available, the program would be inconsistent.

As to the comments by Executive Directors regarding the need for diversification, the staff representative commented that in the past much of the investment that had taken place outside the uranium sector had been devoted either to infrastructure or to the purpose of trying to make the country self-sufficient in food. It was only natural that a country in the Sahel that had been hurt by drought in the past should tend to place great emphasis on that aspect of the economy, and the authorities had used their investments to try to improve methods of cultivation. The other side of the attempt to develop the rural sector had been the establishment of official marketing agencies to handle exports of such crops as groundnuts and onions.

There was, however, a long open border in the south of the country, and most export trade was guided by free market conditions. For instance, the Government might wish to expand the export of processed livestock products, but there was a border market for the export of livestock on the hoof, with which the Government did not interfere.

In the circumstances of Niger, the whole question of producer prices was difficult to handle, the staff representative noted. At present, the prices received by the farmer in the free market were higher than those offered by government agencies. It was also doubtful whether the government agencies could offer a desirable producer price, cover their own costs, and still sell the product in a weak world market. Just because offering official producer prices was one way of encouraging production, it was not certain that handling marketing through official agencies was the best method. Other intermediaries might be able to handle commodities better.

While the bulk of the emphasis in the rural sector had to be on improving the conditions of production, the staff representative remarked, the authorities could not act alone. The World Bank and one major bilateral partner country were reassessing the rural projects to see that they were appropriately adapted to the specific environment of Niger. Unfortunately, the data for some of the necessary studies, to be conducted in the coming year, were not yet available.

Some Executive Directors had commented that there might be a need for much investment and large capital imports to bring about export diversification, the staff representative recalled. His own view was that it might be just as important to work on import substitution, and that it would be unwise to focus exclusively on export diversification. It was not clear to him that large investments were needed to bring about an increase in productivity in the rural sector. What would be required was continuing flows of capital from bilateral lenders on fairly concessional terms. The stock of external debt in Niger had risen substantially in the past ten years, and it would be unfortunate to pump investment into the rural sector at the cost of aggravating the debt service burden. His own approach would be an incremental one in conjunction with the World Bank. The Fund mission would try to provide a medium-term outlook consistent with an investment program in the light of the finances that might be available for the next two or three years.

Replying to the question why the stand-by arrangement had only been for 75 percent of quota, and why greater Fund assistance should not be substituted for debt relief, the staff representative explained that the overall balance of payments deficit could be about SDR 20 million as late as 1987. In other words, there would be a need to finance some SDR 80-100 million over the next four years. In the circumstances, the SDR 18 million provided by the Fund, representing 75 percent of quota, would be a prudent input until a clearer picture of the need for balance of payments financing in the medium term had been prepared.

Taking another approach, the balance of payments deficit was likely to be something like SDR 38 million at the end of 1983/84, so that even with Fund assistance, there would still be a gap to be financed, which the staff had called debt relief. It was not thereby saying that it was normal for the Fund to provide half the projected overall balance of payments deficit and that debt relief should cover the remainder. At the same time, the amount of domestic funds provided for in the investment budget had become very low, falling from CFAF 26 billion in 1980/81 to CFAF 5.3 billion in 1983/84. The effect would certainly be a great stringency in the development effort. Consequently, he would have no objection if more debt relief could be made available.

The picture of the investment stream might become clearer in the first half of November 1983, the staff representative said. The CFAF 10 billion of debt relief shown for 1983/84 was an indicative figure, and it would go some way toward meeting the criticism raised by a number of Executive Directors that the investment effort had been compromised.

One speaker had inquired why the Fund was limiting the counterpart of Fund drawings to the equivalent of the SDR 18 million under the stand-by arrangement, when Niger was also making a current purchase of SDR 12 million under the compensatory financing facility, the staff representative noted. The decision had been dictated by the same prudence that had inspired the authorities to agree on ceilings only for the first quarter of the program year and not for the subsequent three quarters. For instance, although government revenue was shown as increasing by some CFAF 4-5 billion between 1982/83 and 1983/84, there had in fact not been any tax increases in the past three or four years. It was therefore quite possible that the increase would not occur, and some margin had to be left to cover that contingency. Second, Table 5 in EBS/83/194 showed a decline of CFAF 8.9 billion in domestic arrears between 1982/83 and 1983/84. It was possible that the arrears could be reduced even further by the use of the counterpart from the purchase under the compensatory financing facility. If in fact the size of the local currency requirement for the investment budget had to be revised slightly upward, the whole matter could be reconsidered.

Moreover, the staff representative explained, the staff would be watching Niger's exports closely to ensure that the shortfall came out as expected. If, for instance, Niger found itself in a position where it would have to make a repurchase from the Fund, it was important to be sure that some foreign resources were available with which to make it. In other words, the authorities had acted with prudence at each stage of the negotiations.

Commenting on the exchange rate of Niger, the staff representative from the African Department remarked that the argument seemed to be that if the French franc had depreciated relative to the U.S. dollar and if the world price of non-uranium exports had been denominated in dollars, the French franc value of those prices would have gone up, making it

possible to adjust the producer prices for agricultural produce in Niger. He could find no fault with that reasoning except to say that it might well be that official marketing institutions were withdrawing from handling exports of several of Niger's commodities. They did not wish to continue acquiring stocks of the commodities because they might not find it possible to sell them at the prevailing world prices while covering their own costs, whereas local private intermediaries operating in the free market at the border market prices seemed to be managing quite well. The situation was so unsatisfactory that SONARA, one of the export marketing agencies, had been renting buildings and carrying out other operations that were far more profitable than selling commodities for export. There would have been no point in recommending that the authorities should raise prices to producers artificially at the present time.

The staff representative from the Exchange and Trade Relations Department, commenting on the size of the stand-by arrangement, said that there was no question that the program itself was a strong one. In determining the level of Fund support under the stand-by arrangement, the staff considered that Niger's balance of payments need for the program period was no more than what it had proposed, taking into account other sources of financing, including the purchase under the compensatory financing facility, consistent with current practice. In any event, even with the maximum access of 150 percent of quota some debt relief could not have been avoided. As to the mix of debt relief and the availability of Fund resources under the stand-by arrangement, the staff had taken into account the prospective need of Fund support for several years to come. It was important not to use up all possible Fund assistance at an early stage of the program.

The staff representative from the Research Department explained that, as noted in EBS/83/195, the price and volume of uranium exports were set under sales contract negotiated each year well in advance. Table 4 of EBS/83/195 showed that on the basis of negotiations now under way, the volume of uranium exports would fall by 5 percent from 1983 to 1984 on a calendar year basis while the price would increase by 10 percent in SDR terms, with the net effect that the SDR value of uranium would recover by 5 percent in 1984. For the other commodities, the increase in value was expected to be no more than 2 percent in 1984.

Mr. Blandin remarked that the fact that a large proportion of Niger's uranium exports had been bought by France and paid for in French francs had not resulted in lower earnings for Niger, even when those earnings were expressed in dollar terms. The price paid by France for uranium took into account not only the appreciation of the U.S. dollar against the French franc but also a premium over the world price.

Mr. Malhotra referred to Table 2 on page 4 of EBS/83/194: after falling by 17.4 percent in 1981, Niger's imports had fallen by a further 29.8 percent in 1982 and were expected to fall again by a further 22.4 percent in 1983 and a further 12 percent in 1984. Speaking more broadly, Executive Directors often expressed satisfaction at the way in which the current account deficits of non-oil developing countries were being reduced. However, the present instance of import reduction in Niger was depressing. While there might have been a sudden surge in export receipts because of a good market for uranium, it was important to see what had been happening to the economy of Niger over the longer period. It was also important to look at import substitution to see the factors that were affecting the economy as a whole. In other words, in order to comment with full knowledge on the adjustment process in a given country, one might require a deeper analysis of what was taking place.

The staff representative from the African Department explained that, between 1977 and 1980, there had been a great uranium boom; in 1979, for example, export volume had risen by as much as 47.5 percent. A great deal of foreign borrowing had taken place because it was expected that payment on the debt service would be no problem. Heavy investment had been undertaken. At the same time, domestic arrears had accumulated because of unplanned extrabudgetary expenditures. The Niger authorities themselves had decided that it was not in their interest to continue with that sort of expenditure policy, especially as independent studies on the uranium sector undertaken by U.S. AID and by other organizations were not optimistic about the prospects for nuclear energy in the remainder of the 1980s. In the circumstances, it might be that the only way to bring about adjustment would be to cut down the volume of imports. Although such a proceeding was painful, the authorities had agreed that that was what they wished to do.

Mr. Erb commented that he wondered what lesson could be drawn from the experience of Niger with respect to the management of external reserves during a period of strong export growth. A case could at least be made that the authorities should have built up their reserve position more actively during the boom years in order to be able to deal more effectively with cyclical movements in the market. It was true that the uranium market had been struck by a structural shift as well as by a cyclical shift, thus compounding the problem; even so, the authorities would have benefited by having established larger reserves.

The staff representative from the African Department agreed with Mr. Erb.

Mr. Polak noted that the staff representative from the African Department had stated that domestic agriculture had improved so considerably that Niger would be able to make do with smaller imports of foodstuffs. He hoped that the statistic would be able to show that change in the future.

The staff representative from the African Department mentioned that the OPVN--the food marketing agency--expected to be able to reduce its imports during the coming year; it would in fact even be purchasing a smaller proportion of domestic production because it had been able to set aside some of the past crops. The past efforts of the agricultural sector had in fact helped to conserve food and to avoid unnecessary imports.

The Chairman said that on a future occasion he would like to see a comment on the benefits that Niger had derived from the uranium boom. The authorities had probably overborrowed and overspent in the capital sector, but he wondered whether they had thereby improved either the conditions for agriculture or the export prospects in other areas. The question was clearly an important one in examining the medium-term prospects for Niger. Naturally, any attempt to answer the question would require a look into the further past.

Mr. Joyce commented that, while the study suggested by the Chairman was certainly worth carrying out, oil and mineral booms took place in developed countries as well, and certainly led to some waste of capital.

Mr. Alfidja mentioned that he had been involved in the uranium boom, and that he might elaborate on the lessons both for the Fund and for the World Bank on a future occasion. Some four or five years previously, the Niger authorities had asked the World Bank to undertake to study the lessons that could be drawn from the uranium boom. The consultant from the World Bank who had prepared the study had offered rather optimistic projections and conclusions. That optimism had at the time been shared by some foreign investors and commercial banks. When the downturn had started in 1980, his authorities had again approached the World Bank for a reassessment of the earlier conclusions, the circumstances having worsened. He would therefore prefer to wait until the forthcoming report became available. Meanwhile, the authorities had themselves reassessed their policy, halted some of their investments, and decided on a consolidation program, which was to be reviewed by the joint Fund-Bank mission in Niamey. In any event, he would convey all the comments made by Executive Directors to his authorities, who would certainly take them to heart.

Then the Executive Directors took up the proposed decisions.

Mr. Polak referred to the proposed decision on the purchase under the compensatory financing facility (EBS/83/195, page 11) and suggested that the limitation of six months should be waived "with respect to exports other than the country's main export."

Mr. Alfidja said that he would prefer the original language. Although the staff had made a projection for only six months, the price of uranium for the remaining eight months was already known. While he understood that in practice the adoption of the language proposed by Mr. Polak would not change the impact of the decision for Niger, there were Executive Directors who did not wish to see the adoption of a waiver as a precedent. He himself was worried by

the precedent that the Executive Board might be setting by modifying a text that had already been applied in certain other instances. However, if Mr. Polak felt strongly, he could accept his language.

Mr. Laske recalled that he also had spoken about the waiver contained in the decision on the purchase under the compensatory financing facility. He had great sympathy with Mr. Polak's proposal. Particularly because there had only been one exception in the past, it would be helpful if it were expressly stated that the exception applied only to exports other than Niger's major export commodity.

It was agreed that the waiver should apply to exports from Niger, other than those of uranium.

The Executive Board then adopted the following decisions:

Stand-By Arrangement

1. The Government of Niger has requested a stand-by arrangement for the period from October 5, 1983, to December 4, 1984.

2. The Fund approves the stand-by arrangement attached to EBS/83/194, Supplement 1 for an amount equivalent to SDR 18 million.

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

Decision No. 7541-(83/147), adopted
October 5, 1983

Compensatory Financing Facility - Purchase

1. The Fund has received a request from the Government of Niger for a purchase of SDR 12 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representations of Niger and approves the purchase in accordance with the request.

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

4. The Fund waives the limitation of six months for the estimation of merchandise exports, other than uranium, imposed by paragraph 5 of Executive Board Decision No. 6224-(79/135).

Decision No. 7542-(83/147), adopted
October 5, 1983

3. SIERRA LEONE - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Sierra Leone (SM/83/200, 9/7/83), together with a decision concluding the 1983 Article XIV consultation with Sierra Leone. They also had before them a report on recent economic developments in Sierra Leone (SM/83/202, 9/21/83).

Mr. Sangare made the following statement:

I would like to thank the staff for its well-prepared and comprehensive set of papers, which describe very clearly the financial and economic problems that have continued to confront the economy of Sierra Leone since the Article IV consultation considered by the Board on June 16, 1982. The staff has been frank in pointing out that the authorities have been increasingly vigilant in trying to find solutions to these problems. To this end, they have been discussing with the staff in order to put together a stabilization program that could be supported by the Fund. My authorities, therefore, view today's discussion as an important further step toward paving the way for a Fund-supported program.

In recent years, the economy of Sierra Leone has been experiencing serious economic and financial difficulties. For the past two consecutive years, 1981/82 and 1982/83, the economy has remained stagnant, reflecting largely the decline in production in the agricultural and mining sectors. In the case of the latter, production recovered somewhat in 1982/83, with a growth of 4.3 percent resulting mainly from the increase in bauxite production and the resumption of iron ore mining. Inflation, which had abated in 1980/81, accelerated in the past two years, and consumer prices rose by 37 percent in 1982/83.

The financial position of the Government remains weak, reflecting, in part, the slow growth in revenue as a result of the declining profitability of the major diamond enterprises, a contraction of external trade, and the high level of public sector spending. Even though no extrabudgetary expenditures were incurred in 1982/83 and total expenditures were below budget estimates, the budget deficit widened to 13.5 percent of GDP on a cash basis, largely because of shortfalls in revenue.

The balance of payments position remains weak despite some improvement in the current account deficit, which narrowed from SDR 158.7 million in 1981/82 to SDR 104.7 million in 1982/83. With the fall in the value of exports by 8 percent resulting largely from depressed export prices, the improvement came mainly from a substantial reduction in imports in the face of a tight foreign exchange situation. With an increase in long-term capital inflows stemming from borrowing undertaken by

public sector enterprises, the overall balance of payments position also improved. Nevertheless, the foeign exchange situation remained tight, and Sierra Leone incurred further payments arrears, though not as much as in the previous two years.

As already pointed out, the authorities are seriously concerned about the state of the economy and recognize fully the need for taking action to improve the situation. Thus far, they have adopted corrective measures including the establishment of a dual exchange rate system in December 1982. In close consultation with the Fund, they unified the rates at a level representing a devaluation of about 100 percent in domestic currency terms on July 1, 1983. This was further to improve the profitability of the export sector, particularly the diamond subsector; to assist in enlarging the diversification base; and to rechannel the bulk of export proceeds through official channels.

In the particular case of diamond production, which is inherently susceptible to smuggling, the authorities have taken steps to diversify away from alluvial mining because of its openness to illicit trading. The Kimberlite project has been redesigned in order to reduce the gestation period and accelerate production. As a consequence, production is expected to commence in 1983/84 with a total output of 27,000 carats, rising to 70,000 carats in 1985/86. Financing arrangements for the project are being finalized. With regard to other mining activities, the authorities resumed exploitation of iron ore deposits with the opening of the Marampa mine, with a total output of 140,000 tons. It is expected that output will rise to 1 million tons a year at full capacity. As a result of the construction of improved drying facilities, production of bauxite rose by 3 percent in 1982/83. An alumina plant will also be built at Port Loko in association with a consortium of foreign companies.

The Sierra Leone authorities have been concerned by the poor performance of the agricultural sector. In this connection, they are preparing a public sector investment program which is to be incorporated in a three-year Second National Development Plan 1983/84-1985/86 aimed at raising output capacity, generating growth, and achieving a viable balance of payments position. Accordingly, emphasis is being place on, among other things, the development of the agricultural sector, for which an amount equivalent to 23.5 percent of total resources has been earmarked. Other projects include the Integrated Agricultural Development Project; and the development of hydroelectric power is aimed at reducing imported fuel. The Sierra Leone authorities are hopeful that about 82 percent of total resources required for these projects will be financed through foreign assistance. To this end, a donors' conference is tentatively set for the end of 1983 under the auspices of the World Bank.

In order to further encourage production and reduce the incidence of smuggling, the authorities have announced substantial increases in the prices of the main export crops for the 1983/84 growing season. These include increases of 82 percent for coffee, 93 percent for cocoa, 82 percent for palm kernels, and 15 percent for ginger. This is in addition to the prices awarded in 1982/83, and, as a result, producer prices in Sierra Leone now compare favorably with those prevailing in neighboring countries. In the case of rice--the staple crop--the producer price was raised by 75 percent in 1981/82 and by a further 42.9 percent in February 1983. The authorities have also stated that they intended to decontrol the retail price of imported rice in order to encourage private importation and improve supply.

The authorities are making renewed efforts to reduce fiscal imbalances. The 1983/84 budget is projected to reduce the overall deficit from the equivalent of 13.5 percent of GDP in 1982/83 to 8.4 percent on a cash basis through continued implementation of the strict expenditure control measures already in place. However, the authorities have found it necessary to allow some growth in certain expenditure items that have hitherto been suppressed. These items include provision for revenue-collecting departments. Furthermore, allowance has been made for the maintenance of existing infrastructure and other capital assets. In addition, an amount of Le 5 million has been included to further reduce domestic arrears. On the revenue side, the expected increase reflects revenue gains resulting from the unification of the exchange rate as well as recent price measures taken to improve the supply situation.

With regard to public sector enterprises, measures are being taken to improve their financial positions and make them financially self-supporting. To this end, the Sierra Leone Electricity Corporation was awarded a 70 percent increase in tariffs in March 1982 in line with the recommendations of the World Bank. On July 1, 1983, the authorities allowed a complete passthrough of the exchange rate effects on a number of petroleum products. In the case of gasoline, the price was increased by 47 percent, and this was also allowed to be reflected in bus fares and taxi rates.

The conduct of monetary policy has mainly been influenced by developments in the government sector. The authorities have expressed their intention to pursue a cautious approach to monetary policy, in line with the need to reduce inflationary pressures. Accordingly, a modest expansion of credit to the Government has been allowed in 1983/84. To attract nonbank sources to finance the budget deficit--and in line with the overall review of the structure of savings deposit rates, which were raised by an average of 2 percentage points in July 1983 as a means to encourage mobilization of domestic financial

savings--the interest rate on government paper will be increased by 2 percentage points. At the same time, ceilings on lending rates have been abolished. Meanwhile, the authorities are expected to provide adequate credit to the private sector in line with the quarterly quantitative guidelines to be adopted in the near future.

The projected outturn for the balance of payments in 1983/84 indicates further improvement in the current account, through continued reduction in imports combined with an expected increase in exports resulting from the recovery in production and anticipated gains in export prices. With an increase in official transfers, the overall deficit is also expected to narrow significantly, despite shortfalls in long-term capital inflows.

With regard to external debt, the authorities have completed discussions with the non-Paris Club creditors to reschedule these debts, and the terms obtained are comparable to those agreed upon by the Paris Club creditors. Meanwhile, the authorities have expressed the intention to seek further relief from the Paris Club creditors. They are also seeking assistance from the Fund in data collection and management of debt. On the question of external arrears, the authorities are hopeful that a reduction and eventual elimination could start as soon as the foreign exchange situation improves.

In conclusion, I should like to emphasize that the authorities have demonstrated willingness and firmness to implement strong and comprehensive measures to generate growth and achieve a viable balance of payments position in the medium term. It is important to note that these corrective measures are being implemented in the context of a stabilization program, the key elements of which have already been agreed upon with the staff. Indeed, it is clear that the objectives of the program could be achieved only with external financial assistance from donors and other multilateral institutions. The important role of the Fund in this regard cannot be overemphasized.

Mr. Clark stated that he broadly endorsed the staff appraisal and could support the proposed decision. Clearly, the authorities in Sierra Leone were facing a difficult, but not impossible, task in trying to reduce the present financial imbalances. They had already shown that they recognized the need to take firm measures, notably by devaluing the exchange rate and increasing prices in the June 1983 budget. It was encouraging to read that the staff and the authorities had done a substantial amount of work to pave the way for a financial program. He hoped that, subject to the outcome of the discussion at EBM/83/146 (10/3/83), the forthcoming mission would be able to make further progress toward a stand-by arrangement with a strong structural content.

The successful completion of such an arrangement would be a first step toward achieving a sustainable balance of payments position in the medium term. There were a number of points that such a stand-by arrangement should cover.

On the domestic side, Mr. Clark went on, he hoped that the authorities would concentrate their efforts on increasing the efficiency of fiscal management, while continuing to improve production and supply. In fiscal policy, the overriding need was clearly to control expenditure. In that connection, three points needed special attention: first, he hoped that the authorities would succeed in containing any wage pressures in the private sector that might follow the recent devaluation of the leone and the salary increases for public employees. Second, despite the increases that had taken place on July 1, 1983, he understood that current gasoline prices still involved an element of subsidy. The subsidy should be phased out by passing through the effects of the devaluation to the domestic economy. He had been glad to read that the authorities expected the subsidy to last for only part of the current fiscal year. Third, the authorities should continue to work for better planning and coordination of investment projects. As well as keeping expenditure under control, the aim should be to secure noninflationary domestic financing.

He welcomed the intention to finance the current budget deficit by the issue of treasury bills and to finance development expenditures by issues of stock, Mr. Clark commented. He would however be interested to have the staff's view on the extent to which such securities were likely to be taken up by the nonbank private sector. If they were well received, advances from the Bank of Sierra Leone could be restricted to providing temporary bridging finance only. He noted that certain interest rates had been increased. Any further moves that the authorities were able to make toward establishing positive real interest rates should help to secure a more appropriate overall pattern of saving and investment, and should facilitate in particular the financing of the budget deficit.

While working to improve the public finances, he hoped that the authorities would also continue their efforts on the supply side, Mr. Clark observed. He welcomed the substantial increase in producer prices for the main export crops, which had again been announced well in advance of the 1983/84 crop season. As well as enhancing supply incentives generally, the authorities' action should help to reduce smuggling of agricultural produce. Similarly, it was encouraging to hear of developments in the Kimberlite project, which should reduce illicit trading in diamonds. He would be interested to know when the financing arrangements for the project would be completed. Diversification and improved efficiency would be important not only in agriculture and mining, but also in the energy sector. The Bumbuna Hydroelectric Project would make a vital contribution to reducing dependence on oil imports. There too, it would be interesting to know what progress the authorities had made in raising the necessary finance.

On the external side, Mr. Clark remarked, there were four areas that his authorities considered would be central to any successful adjustment effort. First, a major aim should be to boost the reflux of foreign exchange into the official reserves. He urged the authorities to improve reinforcement of foreign exchange surrender requirements and to work toward the elimination of special retention privileges. Second, the recent reunification of the exchange rate was welcome. For the future, the maintenance of a unified and competitive exchange rate should be a key element in any stand-by arrangement. Third, he agreed with the staff that the authorities should reduce their reliance on exchange restrictions and eliminate bilateral payments agreements as soon as the balance of payments position permitted. Fourth, he strongly urged that a program for eliminating arrears of debt should be incorporated in any stand-by arrangement. Any technical assistance that the Fund could give in improving the monitoring of arrears would be helpful. Did the staff know what the authorities' plans were for eliminating arrears?

He hoped that the stand-by arrangement would include strong undertakings by the authorities to intensify their adjustment effort should the need arise, Mr. Clark went on. Moreover, the mid-term review should offer the prospect of firm understandings on all the key policy instruments. Particularly important would be understandings on the appropriateness of exchange rate policy and on the elimination of arrears.

He had found the comment on the medium-term debt service and balance of payments projections contained in Appendix IV to SM/83/200 to be helpful, Mr. Clark observed. Such projections were an important element in Fund surveillance, especially for economies with structural weaknesses that would take some time to correct. In the present instance, the figures in Appendix IV served to underline the need for a sustained adjustment effort, backed by support from the Fund. Finally, on page 23 of SM/83/200, it was estimated that in the next few years the total annual financing gap, including Fund repurchases, would be about SDR 50 million. He would be interested to hear how that gap was to be covered.

Mr. Doe commented that it appeared, not only from the staff report but also from Mr. Sangare's statement, that the imbalances that had beset the economy of Sierra Leone a few years previously had persisted in 1982/83. Indeed, for the third year running, total output had remained virtually stagnant, while the inflation rate had risen from less than 14 percent in 1980/81 to 37 percent two years later. The overall fiscal deficit had exceeded the equivalent of 10 percent of GDP annually during the past five years, reaching a peak of 13.5 percent in 1982/83. The financing of that deficit had been the main contributing factor to the sustained expansion of total domestic credit, since bank credit to the Government had grown by 38 percent a year on average from 1978/79 to 1982/83. In the external sector, export earnings had declined each year during the period under

review, except for a short-lived improvement in 1979/80. The external debt ratio had risen significantly, and substantial external payments arrears had been accumulated over the years. Needless to say, those imbalances reflected the effect of exogenous factors such as the recession in developed countries, the rise in foreign interest rates, and the appreciation of the U.S. dollar, as well as some inadequate domestic policies. To restore some viability in the economy, the Government had taken a number of measures, notably in connection with the exchange rate, pricing, and financial policies.

On the exchange rate front, the July 1983 decision to unify the official exchange rate with the commercial bank rate, amounting to a near-100 percent depreciation of the leone, was a welcome development, Mr. Doe said. The beneficial effect of that action on resource allocation, the tax base, and the movement of goods toward the domestic organized commercial centers would, he hoped, outweigh the unfavorable repercussions on production costs as well as on the cost of living. The authorities should be encouraged to adopt a flexible approach to exchange rate policy in due course.

The Government had taken decisive steps in the pricing field, Mr. Doe observed, not only in connection with the exchange rate action but also as part of its effort to stimulate output, combat smuggling, and restrain consumption. Producer prices for the two main cash crops--coffee and cocoa--had been raised sharply before the beginning of the 1983/84 crop season, a clear inducement to increase production and bring the output to the country's official trading centers. The decision to raise the producer price of rice, a major item in the local diet, by an average of nearly 60 percent during the period 1981-83 should be an incentive to increase production. The recent increases in the price of gasoline, electricity, and--more important--the effect of the exchange rate adjustment on the cost of living and real income, together with a rather more restrained fiscal and monetary policy, would help to slow the growth of aggregate demand. In any event, the Government's intention to implement the price control policy in a flexible manner was to be encouraged. The authorities' pragmatic attitude regarding income and price policy was also evidenced by their decision to raise nominal wages by only 20 percent in 1983/84, after three years of salary freeze, price increases having averaged 32 percent a year in 1981-83.

In the fiscal sector, Mr. Doe considered, the favorable revenue effect of the increase in producer and consumer prices, together with the recent depreciation of the leone, would probably exceed the higher expenditure costs. Furthermore, the strengthening of expenditure control through a monthly authorization of appropriations and the stricter enforcement of laws applicable to government recourse to bank financing were steps in the right direction. The increase in the interest rate on treasury bills and government bonds was also useful. The rise in the liquidity ratio applicable to commercial banks and the

implementation of more restrictive guidelines for bank credit could help to dampen the growth of private sector demand. He hoped that some credit would be available for financing productive activity.

As to the external debt, Mr. Doe commented, the Government's success in preventing the accumulation of domestic arrears in 1982/83 was a welcome development. Similarly, its efforts to complete the negotiation of debt relief with non-Paris Club creditors, as well as to undertake discussions with the Paris Club, were to be encouraged. The authorities should persevere in their attempts to reduce the debt service ratios to more manageable levels, and to restore the creditworthiness of the public sector. The close cooperation of major creditors would be helpful in that respect. In conclusion, he hoped that the Fund and the Government of Sierra Leone would reach a workable agreement soon, and that the Fund and concessional lenders would provide the necessary financial assistance to the country in support of the authorities' efforts to restore viability to the economy. He supported the proposed decision.

Mr. Erb stated that there were two points on which he would have liked to see further elaboration. It was clear that the problems of Sierra Leone were severe and likely to continue well into the future. That situation raised a question about the relative involvement of the Fund and the World Bank in Sierra Leone for the medium term. What plans did the World Bank have to expand its assistance efforts, both financially and in the provision of overall guidance for the economy? There were clearly many internal problems that needed handling with the sort of expertise available in the World Bank. There were also problems on the exchange rate side where the Fund could offer expertise in trying to overcome the rigidities and constraints. The other part of his question was, how closely would the Fund and the World Bank work together in Sierra Leone, and what were the short-term intentions in that respect?

The staff representative from the African Department remarked that he had taken note of the desire to see more analysis of the medium-term prospects for Sierra Leone. If the staff returned to the Executive Board with a program for the country, it would certainly take that desire into account.

The World Bank was involved in Sierra Leone both with financing and with the provision of technical assistance, the staff representative continued. On the financing side, the World Bank was considering financial assistance for the agricultural sector. It had also been helping the authorities with the Bumbuna Hydroelectric Project and, more generally, with their planning activities.

Most of Mr. Clark's desires had already been set out in SM/83/200, the staff representative went on. The remainder would certainly be taken into account in drawing up any program that might be concluded. As to the potential for the nonbank sector to subscribe to treasury

bills in Sierra Leone, in the past, the major nonbank institutions that had contributed to government finance had been the Marketing Board and the Diamond Company. With the recent policy measures enacted by the Government, it was possible that the financial position of those two bodies would become strong enough to enable them to increase their contribution to government finances. The authorities had indicated that they would increase the interest rates on that sort of paper, as well as converting some of the government debt into treasury bills and bonds, in the expectation that a number of investors, including private individuals, would be encouraged to hold them. The authorities would be holding further discussions regarding the Kimberlite project in London. As to the progress of financing for the Bumbuna project, the donors' conference that the World Bank had been planning had been delayed because the World Bank had felt that insufficient weight had been given to the implications of the project for debt service for the budget. It had therefore asked the authorities to proceed rather more slowly in view of the imbalances in the Government's finances at the present time.

Commenting on the plans to reduce commercial arrears, the staff representative explained that the authorities were well aware that commercial arrears did involve major additional costs that went to increase the import bill. Any discussions about a Fund-supported program would have to provide for a credible reduction in arrears. The authorities would like to go as far as possible, but the staff had not yet discussed the amount by which external arrears would be reduced.

Executive Directors had also inquired how the staff envisaged that a financing gap amounting in the medium term to some SDR 52 million a year would be financed, the staff representative from the African Department recalled. Neither the authorities nor the staff had any illusions that the task of restoring the economy of Sierra Leone to medium-term balance would be a long one. The imbalance was large, and, apart from debt rescheduling, the authorities expected that, if they established a credible track record with the Fund, the relationship with the Fund might last considerably longer than one year.

Mr. Erb said that he would be especially interested in learning not only how the staff felt that the medium term gap would be financed, but also what internal adjustments would be necessary in order to try to reduce it. In other words, where did the World Bank, the Fund, or other agencies, consider that the Government should set its priorities if the gap was to be reduced? There were many problems besetting the economy; it was important for the authorities to identify and to give special attention to those areas in which they could accomplish the most rapid possible reduction in the external financing gap.

The staff representative from the African Department remarked that, within the context of the Fund program, the staff would expect the authorities to continue to implement stringent demand management

policies not only in the short run but also in the medium term. Second, the authorities would need to accelerate their export drive. Third, they should move rapidly in connection with the regulation of surrender requirements and special retention permits. That whole matter was however rather delicate, and the authorities would have to proceed cautiously. While it was true that those two aspects had a key bearing on the financing of the resources gap, it was important for all concerned to move in a credible fashion over a considerable period of time.

The Chairman commented that from Appendix IV, page 34, of SM/83/200 it was evident that the ratio of debt service to exports of goods and services was expected to be over 50 percent in 1983/84 and 1984/85, and to be not much less than 45 percent in 1987/88. He would be interested to know how those payments were to be made and what debt relief operations the staff was assuming. The figures did not give the impression that the country would be on a viable track in three to four years' time. He would therefore like to see a medium-term assessment of the position, together with a rationale for Fund intervention. If the Fund's role was to be that of financier, it would be important to know over what period the Fund was likely to be repaid. Another important point to be settled in advance would be the mix of debt relief, official concessional flows, and Fund financing. It was clear that the position of Sierra Leone was difficult, and the Fund's approach should be cautious.

Mr. Sangare said that he agreed with those who had commented that the authorities should apply the surrender requirement much more strongly. There was however some hope that the financing gap could be reduced, if only because it seemed likely that the unification of the exchange rate on July 1, 1983 would have a beneficial effect on the foreign exchange situation of the Bank of Sierra Leone. It seemed possible that some of the major companies--the groups that would benefit most from reunification--would be readier to surrender their foreign exchange to the Bank of Sierra Leone. Hitherto, the lack of foreign exchange in the Bank of Sierra Leone had led to a lack of confidence, so that companies had been reluctant to surrender any foreign assets. With the return of confidence, it should be easier to enforce the surrender requirement.

The authorities of Sierra Leone had shown their determination to realign their economy in order to bring it back onto a path that would be viable for the future, Mr. Sangare considered. His authorities would like to count on the Fund's assistance in the form of a stand-by arrangement, for which they had taken almost all the basic steps. Without prejudging the outcome of the mission that was to visit Sierra Leone shortly, it would be an encouragement to the Sierra Leonean authorities to grant them a stand-by arrangement. He would convey the comments made by Executive Directors to his authorities, and he felt that they would soon reach agreement with the Fund staff.

The Chairman made the following summing up:

Directors agreed with the general thrust of the views expressed in the staff appraisal. They were concerned that the economic and financial difficulties have persisted and are intensifying, thereby requiring determined efforts on the part of the authorities, particularly to reverse the widening fiscal gap.

Directors noted the authorities' increased awareness of the need to implement strong and appropriate adjustment measures. They welcomed the recent implementation of several policy measures, including steps to increase mineral and energy production and to curb aggregate demand through a combination of actions to reduce the budget gap, liberalize pricing and interest rate policies, and reduce the excess liquidity of the commercial banks. Directors were also encouraged by the authorities' decision to unify the exchange rates on July 1, 1983, involving a substantial depreciation of the leone, and the announcement of sizable increases in the producer prices of export crops. They urged the authorities to continue to implement a flexible exchange rate policy. They also urged the authorities to eliminate the remaining subsidy on domestic energy prices, to prune public investment, to avoid wage pressures, particularly in the public sector, to implement more effective surrender requirements for foreign exchange earnings, and to reduce retention privileges.

Directors also expressed concern about the rapid accumulation of external payments arrears and about the high external debt. Directors noted that the sustained implementation of adjustment policies should lead to a progressive reduction in external arrears as well as in other restrictive policies.

Directors expressed the hope that progress could be made toward the introduction of a meaningful stabilization program that might receive Fund financial support. To be credible, such a stabilization program would have to include decisive measures in the fiscal field as well as a viable medium-term scenario leading toward a viable external balance of payments position.

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

The Executive Board took the following decision:

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

2. Sierra Leone's exchange system involves restrictions on payments and transfers for current international transactions, including external payments arrears, and a multiple currency practice, as described in SM/83/202. Sierra Leone continues to maintain bilateral payments agreements with Fund members. The Fund urges the authorities to reduce reliance on exchange restrictions, including the associated multiple currency practice, and to eliminate the bilateral payments agreements with Fund members.

Decision No. 7543-(83/147), adopted
October 5, 1983

## 4. EL SALVADOR - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with El Salvador (SM/83/191, 8/17/83). They also had before them a report on recent economic developments in El Salvador (SM/83/192, 8/22/83).

Mr. Senior made the following statement:

On behalf of my Salvadoran authorities, I would like to express their appreciation for the excellent work done by the recent Fund mission in relation to the present 1983 Article IV consultation. The authorities value very highly the Fund's counsel, especially under the current difficult circumstances for the formulation of economic policy and, indeed, have maintained close consultation with this institution since before the beginning of the stand-by arrangement approved by the Board on July 1982. Since that time, there has been a review of the stand-by arrangement--discussed by the Board last May 27--at which time the program's performance criteria for the last six months were quantified. As might be remembered by the Board, given the well-known uncertainties regarding the social and political environment in El Salvador in particular, and in the Central American region in general, the program's performance criteria were originally quantified for only six

months. Given our very close latest review of the Salvadoran economy in May of this year, as well as the staff's comprehensive and concise consultation document, I will not dwell on recent economic developments and, rather, will make only a few short comments.

In the first place, I think it is quite evident that our recent discussions on various Central American countries, including the one on El Salvador, clearly point to a similar situation of economic deterioration in all the countries of this region, albeit with differing degrees of severity for particular countries, given their particular circumstances. In general, however, and even making abstraction of the more peculiar circumstances of each country, the Central American economies have been severely affected by the recession in the world economy, a marked deterioration in their terms of trade, a virtual disruption of the regional common market, large capital flight, and also a virtual closure of access to the private international capital markets. This has lately been compounded by the introduction of export quotas on the main export commodities of these countries, such as coffee and sugar. This has all translated into stagnation of economic activity, high unemployment, large payments imbalances, a significant compression of imports, and an overall marked deterioration in the standards of living of the population. The internal political and social situation in many of these countries has given rise to a marked fall in their particular levels of production. In El Salvador, production has fallen by more than 20 percent since 1979.

I wanted to mention these similarities in the region if only to highlight the particular serious economic situation of El Salvador. As should be clear from what has been stated above, even in the absence of an armed internal conflict, the economic situation of El Salvador, the same as that of the other countries in the area, would be cause for serious concern. The well-known present armed conflict, which has not only been prolonged but also generalized throughout the country and all sectors of economic activity, has of course compounded the problems and made the formulation of economic policy difficult. As I have stated before, in such circumstances economic policy cannot be geared to anything but a kind of holding operation in which the fundamental objective should be that of arresting any further economic deterioration while seeking to correct some fundamental distortions in order not to impair irreversibly the country's future possibilities for recovery as conditions become more normal.

Secondly, I think that we can concur with the staff that, if assessed in the light of the aforementioned difficult circumstances, during the past 12 months the Salvadoran authorities

have been able to implement a set of financial policies that have produced positive results. Economic activity has been maintained, or its deterioration has been arrested significantly; inflation, though higher than the program's target, has been maintained at a reasonable level of 12.5 percent. Both of these results are no mean accomplishments, especially in the inflation front if account is taken of the shortages experienced in the past three years.

As I stated before, there is no need to dwell on specific issues or policies; they are well known, and our views on these points have been expressed as recently as May of this year when the Salvadoran program was most recently reviewed. Before concluding, however, I should mention three important exchange and fiscal measures that have been adopted by the Salvadoran authorities since the mission visited San Salvador. Since the end of August, the repatriation of registered foreign investment has been transferred to the parallel market. Liberalizing trade: the prohibition against importing most luxury vehicles was abolished on September 1, 1983. Under new regulations, it is only forbidden to import vehicles larger than 1,600 cc or whose export price is greater than US$8,000. On September 21, 1983, the Monetary Board transferred from the official market to the parallel market the financing of 82 additional import items. This is in full concurrence with the staff's recommendation to continue transferring operations out of the official market, with a view to achieving equilibrium in that market.

The rather satisfactory--under the circumstances--performance of the Salvadoran economy has in great part been made possible by the financial policies adopted and substantial external assistance received by the Salvadoran authorities. In this context, the continuation of such conditions is clearly required, or, as the staff correctly puts it: "...it would be regrettable if that momentum was to be lost by the relaxation of policies...." The authorities are well aware of this, and of the important role the Fund program has played in this regard. Thus, they have instructed me to indicate their intention to continue to avail themselves of the Fund's advice and resources in the near future. It is the authorities' intention to request a new stand-by arrangement as an important means of consolidating and strengthening the adjustment measures already adopted.

Mr. Robalino commented that the economy of El Salvador had failed to grow for a number of years. In 1982, real per capita income had been approximately two thirds of what it had been in 1978, and the prospects for the present year pointed to a further decline in the standard of living of the population. The origins of the problems in El Salvador were well known, and the two staff papers set out the fundamental facts of the situation. There was clearly a need to

strengthen the balance of payments by reducing the fiscal deficit and by adopting a less accommodating monetary policy. He welcomed the persistence of the authorities in gradually shifting transactions from the official to the parallel market, as well as their intention to maintain a flexible interest rate policy. He agreed with much of what was written in the staff appraisal, but he did not understand why the staff did not recommend the approval of the exchange restrictions and the multiple currency practice maintained by the authorities. Any country facing the internal problems of El Salvador was forced to put exchange restrictions into effect. He could therefore not support the staff proposal on that point.

Mr. Erb stated that he was in general agreement with the staff appraisal, and that he could accept the recommendation for nonappproval of the exchange restrictions. It was evident that the economic and financial situation of El Salvador continued to be difficult, and that the adoption of appropriate policies by the authorities was constrained by their reluctance to take the necessary but difficult decisions prior to the forthcoming elections. He agreed with the staff that, during the past year, positive results had been achieved as the result of implementing policies agreed with the Fund. It would be regrettable if the momentum that had been so laboriously built up were to be lost. He particularly shared the staff's concern regarding slippages in performance. In view of the low level of central government revenues in 1983 and of the likelihood that no additional tax measures would be forthcoming, he hoped that the authorities could restrain government expenditure during the final quarter of the year. He agreed with the staff recommendation that work should be started immediately on planning next year's budget, with particular attention to additional taxes, such as a sales tax or a value-added tax, which would be needed to maintain revenues, and he supported the recommendation that the authorities should set expenditure priorities.

As for monetary policies, he noted that interest rates would be negative in the present inflationary circumstances, Mr. Erb observed. He therefore encouraged the authorities to pursue a more active interest rate policy. Private sector investment was a crucial element of the economic recovery, and such investment would be advanced if savings were encouraged by the adoption of positive real interest rates.

In the external sector, Mr. Erb remarked, he was pleased with the progress that the authorities had been able to make in certain fields during the first five months of 1983. If the country's creditworthiness was to improve, however, further substantial progress would need to be achieved in increasing net official international reserves, which had stood at minus $209 million on May 31, 1983, and in eliminating external arrears, which had amounted to $34 million at the end of June 1983. The staff's expectation that net international reserves would increase by $10 million in 1983 and that most outstanding arrears would be eliminated was realistic. The authorities should make every effort to attain, if not to exceed, those targets. While official net capital

inflows had played a major role in the recent improvement in El Salvador's external accounts, the authorities should adhere to policies that themselves would provide significant improvements. Foremost among those would be a reunification of the dual exchange rates. He therefore felt it essential that the authorities should continue to transfer significant categories of transactions to the parallel exchange market in preparation for the exchange rate unification.

Finally, when the Executive Directors had undertaken the review under the stand-by arrangement, he had pointed out the danger of accumulating large stocks of volatile short-term liabilities, Mr. Erb mentioned. Thus, he was pleased that the authorities had succeeded in renegotiating the terms of several short-term credits. Further reductions in short-term debt obligations would serve to ease the current repayment pressures. In conclusion, he urged the authorities to return to an appropriate and prudent policy path as soon as possible.

Mr. Clark said that he too endorsed the staff appraisal and the recommendation not to approve the exchange restrictions and multiple currency practices. He recognized the particularly uncertain situation in El Salvador. In such circumstances, it was unrealistic to have too high an expectation of economic policy. Nevertheless, when the Executive Directors had been discussing the stand-by arrangement for El Salvador in May 1983 (EBM/83/76, 5/27/83), his chair had said that macroeconomic policy could best contribute by aiming at the greatest feasible degree of financial and monetary stability.

Taking up four specific points, Mr. Clark observed, first, that there should be concern about the rapid increase during the past year in expenditure not directly financed by external grants or loans. He supported the staff in recommending close scrutiny of all government spending. He also suggested that the sharp increase in public sector employment made it doubly important that wage increases in the public sector should be restrained. As to interest rates, he noted, like Mr. Erb, that savings account rates were at about 9 percent or 10 percent, while consumer price inflation remained at 11-12 percent. Some adjustment of nominal interest rates to yield appreciably positive real interest rates might be helpful in maintaining domestic savings. It was disturbing to read that one third of all credit to the private sector originated outside the banking system in institutions over which the authorities had only rather loose control.

On the external side, Mr. Clark went on, he would press for reunification of the exchange rate system; meanwhile, he wished to see rates on the parallel market determined as far as possible by market forces. Finally, if there was to be a request for a follow-on stand-by arrangement, it might have been helpful if the present consultation report had included some firmer indication of the elements in such a program, in particular those relating to structural adjustment.

The staff representative from the Western Hemisphere Department, replying to the suggestion that there might be a follow-on program for El Salvador, observed that the situation was complex. It would be difficult to obtain a medium-term outlook because of the political circumstances, which had a negative impact on production in general. All that could be said was that any future program would have to make provision for large expenditures on reconstruction, especially to replace the infrastructure that had been destroyed.

The staff representative from the Exchange and Trade Relations Department explained that the staff had not recommended approval of the exchange rate restrictions and multiple currency practices, because the staff was bound to implement the policy on restrictions and multiple currency practices established by the Executive Board. Two basic requirements had to be met before the staff could recommend approval for the maintenance and retention of exchange restrictions. One was that the exchange restrictions were necessary for balance of payments reasons. In the present instance, the difficulties in the country and in the region might indicate that such restrictions were necessary. There was however a second condition just as important as the first, namely, that the exchange restrictions and multiple currency practices should be seen to be temporary. On the basis of the policies now in place, the staff was not in a position to establish that the restrictions and practices would be temporary; there was therefore no way in which he could recommend that the Executive Board approve them.

Mr. Senior remarked that the economic situation in El Salvador was still difficult, and that prospects for the medium term were uncertain. In the circumstances, the economic performance during the current year had been quite satisfactory. It would hardly have been realistic to have expected much more than had been accomplished. He did not mean that economic policy had no role to play. On the contrary; while present circumstances made the formulation of economic policies difficult, it was precisely in those circumstances that the formulation of policy became more relevant if the marked deterioration in economic activity was to be arrested. Thus, a certain degree of flexibility was needed not only in policy formulation but also in implementation. For instance, in the present circumstances, economic policy did not necessarily have to be spelled out very precisely. What was needed was more of a strategy for economic policy, and a framework to limit its scope.

At the same time, Mr. Senior went on, the quantification of variables should refer to relatively short periods, so that limits could be adapted to changing circumstances. In a way, that was precisely what was being achieved by the stand-by arrangement with the Fund. The continuation of the framework would seem to be necessary if the positive results so far achieved were to be consolidated. It was for that reason that the authorities intended shortly to request the new arrangement with the Fund.

While it was difficult to frame a medium-term policy for the Salvadoran economy, Mr. Senior considered, some important measures had been taken that would have far-reaching effects in the longer term. The agrarian reform, and the nationalization of banks and foreign trade, would surely bring about profound changes in the structure of production and property in the Salvadoran economy. Clearly, it would take a considerable time, and perhaps a restoration of more normal positions in the country, for a full evaluation of the result of such changes to become available. He had been rather surprised by the comments, which he hoped were preliminary, by the staff concerning the effects of the reforms on agricultural and even on industrial production. In the first place, it was too early for any results to be apparent. In addition, significant exogenous factors had been at work that had had a bearing on agricultural and industrial production. To fault the agrarian reform, as had been done in some circles, for the drop in agricultural production would not seem justified. The same phenomena had occurred in all other Central American countries, where no such agrarian reforms had been implemented. Naturally, he should not be taken to mean that there was no room for improvement in the way that the agrarian reform was being carried out.

The Chairman made the following summing up:

Executive Directors were in general agreement with the thrust of the staff appraisal contained in the report for the 1983 Article IV consultation with El Salvador.

Directors recognized the severely negative impact on El Salvador's economic performance of the internal security problems, compounded by the world recession and by the shrinkage of the Central American Common Market. Under these difficult circumstances, Directors credited the authorities for having been able to implement the stabilization program that was supported by a stand-by arrangement from the Fund.

Directors stressed that the momentum gained in the past 12 months by the pursuit of stabilization measures should not be lost prior to the presidential elections. While recognizing the difficult circumstances of El Salvador, Directors stressed that there was scope for more effective corrective policy actions, particularly in respect of budget expenditures and fiscal revenue. Directors noted that fiscal performance remained weak and continued to pose the greatest threat to the stabilization effort. Close scrutiny of all forms of government spending and restraint in public sector wages were called for. Directors were also of the view that the authorities' stance on interest rates and credit policies should be strengthened.

Directors encouraged the Salvadoran authorities to simplify the exchange system, which remains unduly complex, and to eliminate external arrears. Substantial weight needed to be given

to market forces in the determination of the exchange rate in the parallel market, as part of the process leading to the reunification of the exchange rate markets. In the meanwhile it would be necessary to transfer an increased volume of transactions to the parallel market.

It was recommended that the next Article IV consultation with El Salvador should be held on the standard 12-month cycle.

## DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/146 (10/3/83) and EBM/83/147 (10/5/83).

### 5. ICELAND - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that with effect from September 19, 1983 Iceland has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement (EBD/83/248, 9/28/83).

Decision No. 7544-(83/147), adopted
October 3, 1983

### 6. RWANDA - CHANGE IN REPRESENTATIVE RATE FOR RWANDA FRANC

The Fund finds, after consultation with the authorities of Rwanda, that the representative rate for the Rwanda franc, under Rule O-2, paragraph b(iii), is its fixed relationship to the SDR, which is Rwanda francs 102.71 per SDR. The Banque Nationale du Rwanda will promptly advise the Fund of any change in the representative rate (EBD/83/247, 9/28/83).

Decision No. 7545-(83/147) G/S, adopted
October 3, 1983

7. MOROCCO - TECHNICAL ASSISTANCE

In response to a request from Morocco for technical assistance, the Executive Board approves the proposal set forth in EBD/83/249 (9/29/83).

Adopted October 3, 1983

APPROVED: March 19, 1984

LEO VAN HOUTVEN
Secretary