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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/62

10:00 a.m., April 24, 1991

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	L. E. N. Fernando
	S. Gurumurthi, Temporary
C. S. Clark	G. Lindsay-Nanton, Temporary
	Zhang Z.
T. C. Dawson	S. B. Creane, Temporary
	M. E. Hansen, Temporary
	J.-P. Schoder, Temporary
E. A. Evans	
	N. Kyriazidis
M. Finaish	
M. Fogelholm	
B. Goos	B. Esdar
J. E. Ismael	
A. Kafka	J. C. Jaramillo
	J.-F. Cirelli
A. Mirakhor	O. Kabbaj
L. B. Monyake	
D. Peretz	P. Wright
G. A. Posthumus	G. P. J. Hogeweg
	Y.-M. T. Koissy
A. Torres	R. Marino
A. Végh	A. G. Zoccali
	N. Tabata
	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant
B. J. Owen, Assistant

Also Present

IBRD: N. M. Gorjestani, Africa Regional Office. Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; J.-P. C. Gollé, A. D. Goltz, N. S. Jackson, P. J. McClellan, M. Oka, P. D. Swain, H. Wiesner, A. A. Zimmerman. African Department. E. L. Bornemann, Deputy Director; G. E. Gondwe, Deputy Director; N. Abu-zobaa, A. Bessaha, I. C. Lienert. Exchange and Trade Relations Department: A. Basu. Legal Department: H. Elizalde. Secretary's Department: A. Tahari. Treasurer's Department: G. Hacche, S. T. Lurie. Special Advisor to the Deputy Managing Director: W. A. Beveridge. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. A. Ahmed, M. B. Chatah, B. R. Fuleihan, A. Grom., J.-L. Menda, F. A. Quirós, A. Raza, B. A. Sarr. Assistants to Executive Directors: T. S. Allouba, B. Bossone, Chen M., B. A. Christiansen, M. Da Costa, H. Dognin, S. K. Fayyad, O. A. Himani, K. Ishikura, C. J. Jarvis, M. E. F. Jones, P. K. Kafle, K. Kpetigo, V. Kural, W. Laux, R. Meron, L. J. Morelli, F. Moss, M. Mrakovcic, S. Rouai, P. L. Rubianes, Tin Win, S. von Stenglin.

1. INTERIM COMMITTEE - CHAIRMAN

Mr. Clark said that he wished to inform Executive Directors that the Prime Minister of Canada had undertaken a major shift in cabinet positions in his Government, and in so doing he had asked Finance Minister Wilson to take on a new set of portfolios, including industry, science, technology and international trade. In accepting those responsibilities, Mr. Wilson realized that it was customary that he resign from the position of Chairman of the Interim Committee, and he had indicated his intention to do so in a communication he had sent to members of the Interim Committee (see EBD/91/118, 4/22/91). Mr. Wilson also realized that the Committee's spring meeting was only a week away and that preparations were well advanced. He had therefore indicated that if Committee members wished, he was prepared and, indeed, would be honored, to chair the forthcoming meeting of the Interim Committee, whereafter his resignation would take effect.

The Chairman said that he knew that he spoke for all members of the Board in asking Mr. Clark to convey their congratulations to Minister Wilson on his appointment to an exceptionally broad-ranging new ministry as well as their thanks for the outstanding way in which he had chaired the Interim Committee; in a short time, he had established a very high standard of leadership.

Mr. Mirakhor remarked that on behalf of his authorities, he wished to congratulate Minister Wilson and to extend thanks for his efforts as Chairman of the Interim Committee. His authorities would, in the circumstances, be pleased to see Mr. Wilson chair the Committee's forthcoming meeting.

The Chairman then invited the Secretary to advise the Board on how it might proceed in the current situation.

The Secretary observed that the matter was really in the hands of the Interim Committee, whose procedures were sufficiently flexible to deal with the situation, even though there was no precedent of a Chairman being called upon to accept other responsibilities only a few days before a meeting. For instance, there was no requirement that the Chairman be a member of the Committee or that he be a minister or Governor of the Fund. Thus, it would still be possible for members of the Committee to accept Minister Wilson's offer to chair the forthcoming meeting, even if the new Canadian Government appointed its new Finance Minister as a member of the Committee and as Governor of the Fund for Canada.

In the circumstances, a timely response by members of the Interim Committee to Mr. Wilson's communication would be useful, the Secretary concluded. (See responses, circulated as Supplements to EBD/91/118)

The Chairman remarked that he would consult with members of the Interim Committee on Mr. Wilson's offer to chair the forthcoming meeting. He would also ask the Secretary to begin consultations on the selection of a new

Interim Committee Chairman so that the position could be filled as soon as possible.

Mr. Peretz said that the Chancellor of the Exchequer had already indicated to him that he would welcome Mr. Wilson's offer to chair the forthcoming meeting. In view of the short notice of Mr. Wilson's resignation, it might be prudent to take some time to consider the matter of a new chairman rather than to take a decision in the course of the Committee's forthcoming meeting.

Ms. Creane remarked that while she had not had the opportunity to consult with her authorities, her preliminary reaction was that Mr. Wilson's offer was a very gracious one.

The Chairman observed that Directors had taken note of Mr. Wilson's intention to resign as Chairman of the Interim Committee and had agreed to consult rapidly with their authorities on the matter of Mr. Wilson's offer to retain his Chairmanship until the conclusion of the spring meeting of the Committee.

2. ADMINISTRATIVE AND CAPITAL BUDGETS, FY 1992

The Executive Directors, meeting in restricted session, considered the Administrative and Capital Budgets for FY 1992 (EBAP/91/76, 4/1/91; Sup. 1, 4/4/91; and Sup. 2, 4/23/91). They also had before them as background information a report from the Committee on Executive Board Administrative Matters regarding the electronic data processing budget for FY 1992 for offices of Executive Directors (EBAP/91/80, 4/3/91), a nationality distribution list of the staff (EBAP/91/83, 4/5/91), a paper on the review of the Fund's income position for FY 1991 and FY 1992 (EBS/91/67, 4/16/91), a memorandum from the Secretary of the Bank on a standing joint committee of Fund/Bank Executive Directors on Administrative Matters (EBAP/91/43, Sup. 1, 4/22/91), and a paper on Executive Board and other meetings of Executive Directors in 1990 (Secretary's Circular No. 91/64, Cor. 1, 4/22/91).

At the conclusion of the discussion, the Executive Board approved the following decisions, with one objection:

Administrative Budget Estimates, FY 1992

1. Appropriations for administrative expenses for financial year 1992 are approved in the total amount of $330,140,000. This amount will apply to the various categories of expense as follows:

I. Personnel Expenses

A - Salaries	$152,065,000
B - Other Personnel Expenses	81,060,000

II.	Travel Expenses	
	C - Business Travel	28,955,000
	D - Other Travel	17,380,000
III.	Other Administrative Expenses	
	E - Communications	7,740,000
	F - Building Occupancy	21,985,000
	G - Books and Printing	6,575,000
	H - Supplies and Equipment	6,055,000
	I - Data Processing	16,415,000
	J - Miscellaneous	5,540,000
	Total Expenses	343,770,000
IV.	Reimbursements	-13,630,000
	Total Budget	$330,140,000

2. Commitments may be made for each lettered category A-J up to the amount indicated above except that no commitment may cause the total budget to be exceeded. Any commitment going beyond the total approved for each category, or causing the total budget to be exceeded will be submitted to the Executive Board for approval.

3. The total staff ceiling of 1,832.5 and its distribution by departments, bureaus, and offices as set forth in the budget on page 37 (revised) are approved. The staff ceiling shall not be exceeded without prior approval of the Executive Board.

Adopted April 24, 1991

Capital Budget Projects Beginning in FY 1992

1. Appropriations for capital projects beginning in financial year 1992 are approved in the total amount of $9,695,000. This amount will apply to the various categories as follows:

I.	Building Space Facilities	
	A - Headquarters	$ 4,680,000
	B - Other Locations	3,815,000

II. EDP Systems

C - Computing	1,200,000
Total Capital Budget	$ 9,695,000

2. Commitments may be made for each lettered category A-C up to the amount indicated in the total column shown above. Any commitment going beyond the category budget will be submitted to the Executive Board for approval.

Adopted April 24, 1991

Assessment Under Article XX, Section 4, FY 1991

Pursuant to Article XVI, Section 2, and Article XX, Section 4, of the Articles of Agreement, and Rule T-2 of the Fund's Rules and Regulations, it is decided that:

(i) The General Department shall be reimbursed for the expenses of conducting the business of the SDR Department for the period from May 1, 1990 to April 30, 1991, and

(ii) An assessment shall be levied on all participants in the SDR Department. The special drawing rights holdings accounts of participants shall be debited on April 30, 1991 with an amount equal to 0.0172629 percent of their net cumulative allocations of special drawing rights. The total assessment shall be paid into the General Department.

Adopted April 24, 1991

Structural Adjustment Facility Within Special Disbursement Account, and ESAF Trust - Reimbursement of General Resources Account, FY 1991

Pursuant to Paragraph 10 of Decision No. 8238-(86/56) SAF, adopted March 26, 1986, and Paragraph 3 of Decision No. 8760-(87/176), adopted December 18, 1987, it is decided that the General Resources Account shall be reimbursed the equivalent of SDR 11,900,000 for the expenses of administering the Facility and the Trust for the period May 1, 1990 to April 30, 1991, and the reimbursement shall be made at the close of the financial year.

Adopted April 24, 1991

3. RWANDA - 1990 ARTICLE IV CONSULTATION, AND REQUEST FOR STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1990 Article IV consultation with Rwanda and the request by Rwanda for an arrangement under the structural adjustment facility (SAF), together with an appendix providing statistical background information (EBS/91/61, 4/4/91; and SM/91/69, 4/10/91). They also had before them a policy framework paper for the period 1991-93 (EBD/91/100, 4/3/91).

The Managing Director made the following statement:

> There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on April 23, 1991:
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> 1. The Executive Directors commended the Government's adjustment effort reflected in the policy reform program for the next three years as described in this first policy framework paper (Rwanda: Policy Framework Paper, 1991-93). They also noted with satisfaction the Government's commitment to the program demonstrated by taking the most politically difficult measures, such as the devaluation of the Rwanda franc and the increase in petroleum products prices, in the midst of a troubled domestic political situation.
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> 2. In view of the importance of timely external assistance to the successful implementation of the program, the Executive Directors noted with satisfaction the decision of the donors to declare Rwanda eligible under the Special Program of Assistance for Africa, and the good prospects for filling the financing gap for 1991 as confirmed by the recent SPA meeting. A SAL was envisaged for presentation to the Executive Directors in the middle of calendar 1991.
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> 3. The Executive Directors welcomed the market orientation of the reforms as well as the inclusion of the social aspects of adjustment as an integral part of the program. They commended the Government's intention to protect social expenditure within the framework of an agreed public expenditure program while reducing the fiscal deficit as a percentage of GDP.
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> 4. Directors noted the importance of agriculture to the Rwandese economy and commented on the agricultural program with emphasis on the importance of coffee and of decentralized administration. The growth projections in this heavily populated country were viewed as reasonable.

5. The Executive Directors expressed concern about the country's implementation capacity. They also stressed the importance of fiscal discipline and of reducing the demographic growth rate. They took note of the Government's population policy and commended the particular attention given to the promotion of women in development. They also noted with satisfaction that the Government was addressing the question of managing natural resources and protecting the environment.

Mr. Koissy made the following statement:

My Rwandese authorities would like to express their appreciation to management and the staff for their assistance during the negotiations that led to the present request for arrangements under the structural adjustment facility. They are in broad agreement with the thrust of the staff appraisal and have no major difficulties with the policy recommendations.

As indicated in the staff report, during the period 1987-89, the performance of the Rwandese economy weakened substantially owing to the combined effects of worsening terms of trade, adverse weather conditions, and delays in putting in place corrective measures. As a result, real GDP contracted sharply in 1989, export earnings declined by more than half from the 1986 level, and internal and external financial imbalances remained unsustainably high. In 1990, in spite of the authorities' efforts to alleviate the impact of these adverse factors on the economy, the economic situation deteriorated further as sharper terms of trade losses and a decline in the net inflow of external resources were registered. Consequently, domestic and external arrears were accumulated and there was a drawdown of official reserves, which declined from over five months of imports to 2.4 months of imports in 1990. The authorities' attempts at putting in place broad based corrective measures were frustrated by the outbreak of armed conflict in October 1990, resulting in a destruction of economic infrastructure and disruption of economic activities.

To secure an environment conducive to the implementation of the much-needed adjustment measures, the authorities endeavored to stabilize the political situation and to restore peace. These endeavors culminated in an agreement with neighboring countries in February 1991 to tackle the key problem of the refugees, which was the cause of the armed conflict. Discussions were resumed with the IMF and World Bank on a revised policy framework paper and on a medium-term program covering the period 1991-93 for which the authorities are seeking Fund support under the structural adjustment facility.

As indicated in the policy framework paper, the basic objectives of the program are to achieve a rate of economic growth of about 4 percent beginning in 1992, to curb the rate of inflation to about 5 percent by 1993, reduce domestic and external imbalances, and increase net official foreign reserves to the equivalent of about four months of imports by 1993.

In order to ensure the success of the 1991 program, the authorities implemented in November 1990, as prior actions, a number of key policy measures relating to the exchange rate, interest rates, petroleum retail prices, and discretionary revenue measures. They have also implemented a number of reforms in key sectors of the economy.

In the real sector, the authorities' medium-term objective is to ensure food security for the growing population through productivity-enhancing measures such as improved cultivation methods, better land use, and measures to reduce soil erosion. In the cash crop sector, the authorities will begin discussions with the World Bank on the key elements of a long-term strategy for the coffee and tea sector. The objective of this plan is to halt revenue losses in these two sub-sectors and create a more liberal domestic marketing environment.

In the fiscal sector, the authorities will pursue a tight budgetary policy aimed at reducing substantially the fiscal deficit (including grants) to about 5 percent by 1993. The authorities expect to curtail their recourse to domestic bank financing, and their outstanding debt to the banking system is projected to decline over the medium term. To achieve this objective, the authorities have taken steps to reform the tax system so as to improve its efficiency and yield. The reform also aims at gradually reducing the share of trade and production taxes while increasing those based on income and consumption. In the context of the 1991 program, the authorities have already taken a number of discretionary revenue measures, including an increase in minimum import duty rates from 5 percent to 10 percent. They have modified and expanded the base of the turnover tax and raised its rate from 6 percent to 10 percent. Also, specific taxes and user charges were adjusted in line with exchange rate and other price adjustments. In addition, a temporary national solidarity tax is expected to be put in place by end-May 1991. While the revenue impact will depend on the pick up of economic activity, it is expected that the combined effect of all the discretionary revenue measures would yield about 2.5 percent of GDP. On the expenditure side, the authorities intend to maintain strict control over all categories of expenditure items. To this end, a comprehensive audit of the civil service and contractual employees is expected to be completed in 1991 and will provide the basis for a rationalization of personnel policy. Nominal wages will be frozen and only a limited number of new recruitments in education and health will be allowed. Also, budgetary transfers and subsidies are expected to be phased out in line with the improvement in the performance of the public enterprises, and domestically financed capital outlays will be reduced. As a result, it is expected that the growth of current expenditure will be contained at 17 percent in 1991 despite the impact of the devaluation, higher security-related outlays, and the doubling of interest payments.

In the monetary sector, the authorities intend to maintain, throughout the program.period, a restrictive policy stance with a view to mitigating the impact of the substantial exchange rate adjustment on price developments and improving the external position. In this respect, they will endeavor to hold the annual growth of domestic liquidity below that of nominal GDP. It is also the authorities' intention to reduce the Government's indebtedness to the banking system by about 5 percent in 1991. In view of the targeted increase in domestic assets, such a reduction will make room for an increase in credit to the private sector. In order to enhance the mobilization of domestic savings, the structure of interest rates was simplified in November 1990 and all preferential rates were abolished. It should be mentioned that most deposit rates as well as lending rates, which were adjusted upward substantially, are now freely determined. Because of the need to maintain a restrictive credit policy in the early stage of the three-year program, the authorities will continue to exercise direct control and supervision over banks' lending operations as a transitory measure. Over the medium term, it is the authorities' firm intention to rely on indirect instruments of monetary policy.

The structural measures being implemented encompass price and market liberalization, revision of the investment code, and reform of the public enterprise sector. By June 1991, greater flexibility will be introduced in the labor recruitment policies of the private sector. The rehabilitation of the mining sector will be pursued while a five-year work plan for the state mining unit (REDEMI) will be completed by mid-1991. Consistent with the objective of liberalizing the economy in order to foster a more competitive environment, the Government will revitalize the coffee sector with a view to eliminating restrictions on exports and increase the number of traders in coffee. The restructuring of the public enterprise sector will include rehabilitation, privatization, and liquidation of selected enterprises according to a timetable agreed with the World Bank.

In the external sector, the authorities took an important step in November 1990 to correct the overvaluation of the Rwanda franc in order to restore the external competitiveness of the economy. In line with their export diversification efforts they adopted an intensified strategy for promoting exports and developing tourism. Specifics of this strategy are under discussion with the World Bank and its implementation is envisaged for June 1991. In the meantime, export taxes on all exports except coffee have been abolished. The liberalization of international trade will be enhanced with the adoption of a more open general licensing system to be enacted soon. Also, a tariff reform is under way aiming at lowering the overall level of effective protection, reducing exemptions, and rationalizing the structure of the custom tariff. In general, the Rwandese authorities are committed to implementing restrictive financial policies to support their exchange rate policy.

To conclude, it should be stressed, as reflected in the staff report, that my Rwandese authorities have taken important steps toward restructuring the economy and reducing the internal and external imbalances confronting the country. They have shown their commitment to the adjustment process by implementing wide-ranging measures as prior actions. Although they are confident that the policies in place and those envisaged would improve the situation, they wish to emphasize that the success of the program will hinge, to a large extent, on the availability of foreign exchange to support the liberalization of the trade and payments system. They expect that the commitments made at the donors' conference in March 1991 will be forthcoming to underpin their adjustment efforts.

Mr. Koissy, extending his remarks, said that as Directors were aware, Rwanda had been affected by an armed conflict which had delayed the implementation of the adjustment program. He was pleased to bring to the attention of the Board the news that a cease-fire agreement had been reached between the parties on March 29. Military observers from neighboring countries had agreed to monitor the implementation of the cease-fire clauses. Discussions were also under way which should lead to an orderly solution of the refugee problem. In addition, on April 28, the ruling political party was scheduled to hold a congress in order to authorize a modification of the Constitution and thus open the way for a multiparty democratic process in the country. Those developments should contribute to fostering a national dialogue and bring harmony and peace to the country. The restoration of such a sociopolitical climate would also be critical for the success of the structural adjustment program that his authorities were resolutely implementing.

Mrs. Hansen made the following statement:

We welcome Rwanda's agreement with the Fund on a three-year structural adjustment arrangement. Rwanda's significant macroeconomic imbalances and its many deep-seated structural problems need to be addressed promptly and comprehensively. Indeed, the country's persistently declining per capita income level adds special urgency to this task. The authorities have already taken a number of important prior actions, which are an encouraging sign of their commitment to get on with reform, and we hope they will continue to make rapid progress in liberalizing the economy, increasing efficiency, and providing appropriate conditions for private saving and investment.

As for any program, the strong macroeconomic policies are needed to create a stable macroeconomic environment in which to effect structural change. In Rwanda, despite some important revenue-raising and expenditure-cutting measures already taken, and promises for further action, the fiscal outlook is still clouded by the security situation and uncertainty over the future level of military expenditures. Mr. Koissy's statement and his remarks hold out some encouragement about the prospects for peace, and we hope that the situation will soon permit significantly lower military expenditures. In the meantime, the authorities will need to implement agreed policy measures, including the elimination of the coffee subsidy, which consumed some 13 percent of current expenditure in 1990, and the removal of direct and indirect subsidies to public sector enterprises. It will also need to monitor the budgetary situation carefully, taking additional measures as needed.

Monetary policy appears quite restrictive, but we have some misgivings about interest rate policy. The staff report indicates that lending rates, if not other interest rates as well, are significantly negative in real terms and are only expected to become positive by the end of the year. While I realize that the jump in the inflation level expected in 1991 is partly due to the adjustments in administered prices, we are nevertheless concerned that these negative real interest rates will perpetuate a misallocation of resources. I would appreciate some comment from the staff about the underlying rate of inflation and how it compares to the current interest rate structure. In addition, are there any understandings about raising interest rate levels if inflation does not decline as rapidly as expected?

On the external side, we welcome the long overdue devaluation of the Rwandan franc. The staff report cites a number of compelling factors, such as the large exchange rate appreciation in previous years, a very sizable terms of trade shock, and the urgent need to improve competitiveness and diversify exports, which justify this action. These factors, in conjunction with a strong Fund program, made conditions ripe for an exchange rate adjustment.

We look forward to the more regular application of this type of analysis to other countries in the region. Although we welcome the authorities' commitment to manage the exchange rate flexibly, we hope that strong domestic policies and favorable terms of trade developments will make for a reasonably stable exchange rate.

We share the staff's views on the importance of trade liberalization in order to establish appropriate price signals to domestic producers, increase competition and efficiency, and provide imports needed for private sector development. In this respect, the decision to establish an open general licensing system appears constructive. We have some doubts, however, about how the transitional system will work out in practice. We welcome the effort to be made to make foreign exchange allocations more transparent. However, charging a fee for the value of the import license, irrespective of whether the foreign exchange is available, seems destined to discourage importers from using the system. Also, we would be interested in comments from the staff about the amounts of foreign exchange that were expected to pass through this market. With up to 30 percent of total imports qualifying for full, priority foreign exchange allocations, sufficient foreign exchange remain for the so-called nonessential imports? Is the staff also satisfied that there is sufficient institutional capacity to implement the system as designed?

On the structural aspects of the program, the authorities have already taken some important steps, such as price liberalization, and appear to have a very wide-ranging set of additional issues under review, including the reform of the coffee sector, and the privatization and liquidation of public sector enterprises. In these latter two areas, as well as many others, actual reform is to be preceded by studies and the formulation of action plans. This is normal and necessary. However, we hope the Rwandan authorities will complete this preparatory stage according to the agreed timetable so that actual reform can begin as soon as possible.

The Fund's experience in Eastern Europe has demonstrated the pitfalls of allowing the structural reform process, particularly the privatization process, to lag behind economic stabilization. In Rwanda, as elsewhere, it will be important to keep up the pace of structural reform, lest the sacrifices made through tight macroeconomic policies not be rewarded with a substantial increase in output. In this connection, I note that by the end of December, action plans are supposed to be completed for 8 of the 62 enterprises in government hands. I would be interested in knowing how long it is expected to take before the Government will actually have withdrawn from a substantial percentage of these 62 enterprises?

Turning to the medium-term outlook, even under reasonably favorable assumptions of improving coffee prices and very moderate import growth, sizable inflows of concessional external assistance will be needed to finance the large current account deficit. This highlights, again, the need for strong policies, both to sustain these inflows in the immediate future and to promote greater export diversification and less aid dependence over the longer term.

In conclusion, we believe Rwanda is on the right track and commend the authorities for the long list of prior actions they have already taken. We hope that they will keep up the momentum of reform in the years ahead.

Mr. Esdar commented that Rwanda's economic and financial situation had been severely affected by the decline of coffee prices and the consequences of the war in October 1990. It was therefore welcome that the authorities had agreed on the implementation of a comprehensive adjustment program, which seemed to address the most urgent problems, and he could support the staff appraisal and recommendations.

Certainly, the reduction of the budget deficit was of crucial importance, and thus he welcomed the intention of the authorities to pursue a tight fiscal policy stance, Mr. Esdar said. It was encouraging to note that the overall fiscal deficit was projected to decline from 11.7 percent of GDP in 1990 to 5 percent in 1993. That seemed to be appropriate as well, considering the low level of domestic saving. Strict control of expenditure and a timely implementation of the announced tax reform was critical in that respect. However, it was disappointing to note that, in spite of measures to increase revenue for the whole program period, total revenues in terms of GDP were projected to remain below the 1989 level.

Concerning structural policies, Mr. Esdar stated that the authorities' intention to undertake major efforts to reform public enterprises was gratifying. Rwanda's experience with highly protected and inefficient state enterprises certainly underlined the need for privatization and overcoming bureaucratic rigidities. Reforms in public enterprises would also contribute to a better fiscal performance by reducing the amount of subsidies. In that respect, the elimination of most price controls was welcome; however, he sought additional information about the magnitude of the share of so-called strategic products, which would still be subject to price control.

The recent rise of inflation was of major concern, Mr. Esdar continued. Tight monetary policy was, of course, a precondition for achieving the program target of reducing the rate of inflation to 5 percent. In that respect, the exchange rate could play an important role as a nominal anchor once an adequate depreciation had brought the exchange rate in line with the fundamentals. A more ambitious time frame for reducing inflation would also facilitate the return to positive real interest rates. In that respect, he shared the concerns of Mrs. Hansen. As for lending rates, he had noted with interest from Mr. Koissy's statement that they were now freely determined. Did that mean that the ceiling on lending rates mentioned in the staff report had been abolished?

It was emphasized in the staff report, Mr. Esdar noted, that the successful implementation of an adjustment program depended greatly on the political situation in the region. The return to domestic stability would also be a crucial precondition for increasing donors' confidence.

Therefore, he very much welcomed the comments by Mr. Koissy. In addition, he observed that the major problem of rapid population growth had already been addressed in the World Bank Board. He endorsed the proposed decisions.

Mr. Schoder made the following statement:

For Rwanda, the process of adjustment has been postponed for too many years, and it is unfortunate that the country's economic growth has thus been kept below its potential. The precarious situation in which Rwanda now finds itself calls for immediate adjustment. The longer adjustment is delayed, the more painful it must be, especially in a country with a low per capita income. The program before us today therefore had to be ambitious, and indeed it is. It is appropriate that Rwanda's renewed intensive policy dialogue with the Fund is embedded in a medium-term context, with financial resources provided on a concessional basis. The program addresses the basic problems of the economy, and we approve the proposed decision.

After a long period during which Rwanda attempted to implement an ill-conceived development strategy, the authorities have finally decided to follow a growth model which has proven successful elsewhere. This shift in economic policy strategy resembles the process taking place in those countries which are changing their economic regime. As I see it, Rwanda's program is essentially one of structural adjustment. For this reason, the authorities should take full advantage of the fact that until recently, the country has enjoyed a comparatively low debt-service ratio and the absence of an inflationary mindset. In this connection, the process of regional pacification should be firmly pursued since it offers hope that the economic and structural changes will be further enhanced by a reduction in the Government's absorption of resources for noneconomic purposes. The most recent information provided by Mr. Koissy is therefore most welcome.

The first steps in the economic reform process have already been taken, and the fundamental correction of the exchange rate in late 1990 certainly merits mention since it introduces a process of relative price correction which is absolutely necessary if Rwanda wishes to achieve a growth rate in line with the basic needs of its expanding population. It goes without saying that there is no easy way of rapidly and durably improving the social welfare of the Rwandese people, but the medium-term program on which the authorities have embarked will go a long way toward achieving this objective, especially since it explicitly integrates social and environmental policies. In a country where the population growth rate has hovered for many years around 3.7 percent, and where the population density has passed 280 persons per square kilometer--one of the highest in Africa--the social and environmental policies included in the program are of paramount importance for increasing the well-being of the Rwandese people.

The goal of achieving a real GDP growth rate of 3.7 percent for 1992, following five years of declining output, seems unrealistic, and should be revised to take account of the needed postwar reconstruction which will surely affect Rwanda's immediate growth prospects. We would have appreciated more information on the sectoral projections on which the staff's overall growth projection is based: it is our impression that the 3.7 percent rate depends mainly on tourism, mining, and the coffee and other agricultural sectors, the first two of which are closely linked to exports. The devaluation of the Rwandese franc, while providing a strong base for rebuilding output capacity and exports, will not alone suffice: the structural improvements included in the program are also needed but will take time to bear fruit, especially in the above-mentioned sectors. According to the staff paper, mining has been depressed for the last several years and the requirements for rehabilitating this sector will not be known until mid-1991, while agricultural development is limited by the scarcity of land as well as by declining crop yields on existing farmland as a result of overexploitation under the pressure of population growth. Results from increased fixed domestic investment through higher domestic savings and improved efficiency cannot be expected very soon.

Rwanda's economic growth should be partly export led, but 85 percent of the country's exports now consist of coffee and tea. The authorities are rightly concerned about the economy's heavy dependence on the coffee sector, whose performance has been disappointing for several years: lower world prices have been accompanied by decreases in both the quantity and quality of coffee exports. The program should focus first on halting, and later on reversing, the decline in the quality and volume of Rwanda's coffee exports, since these can be controlled and the world coffee price cannot. Where tourism is concerned, Rwanda's natural beauty and national parks make it a candidate to become an important tourist center in Central Africa. However, the risks involved in large investments in hotels, transportation, and communications aimed at catering to the tourist trade are considerable: a specific site, or even country, can be the object of fashionable demand one day and not the next. Moreover, the tourist industry depends heavily on imported goods: building materials, furniture, even consumer goods, and much of the foreign exchange it generates are absorbed in keeping it running. In addition, since tourism depends on confidence, the effects of the recent hostilities in Rwanda could take some time to overcome. These remarks should not be interpreted as discouraging the fostering of tourism and the development of an appropriate tourist infrastructure, but only as urging a prudent approach which does not put all Rwanda's eggs in one basket.

Despite an expected drop in income and profit taxes owing to weak economic activity, total fiscal revenues are supposed to rise by 33 percent in 1991 as a result of the exchange rate adjustment and the set of fiscal measures described in the staff report. This expectation also seems rather optimistic. The imposition of a solidarity tax on all wages and salaries to absorb the costs of the war, and the freeze of nominal wages in the public sector with inflation expected to rise to 30 percent in 1991, will place a heavy burden on a population with an already low per capita income which has been further impoverished by the war. In this light, the projected recovery of domestic savings also seems very rapid.

Let me conclude these remarks by expressing our hope for the success of Rwanda's program under a structural adjustment arrangement will be successful and our support for Rwanda's authorities.

Mr. Cirelli observed that Rwanda's economy had been weakened over the past decade by multiple adverse developments, and adjustment had been long overdue. More recently, the outbreak of war had led to large security outlays and severe damages to infrastructure. In order to cope with that difficult situation, compounded by rapid population growth, the Government had adopted a medium-term strategy that encompassed wide-ranging macroeconomic and structural adjustment policies. Those adjustment measures were courageous, and the Rwandese authorities were to be commended for what they had already achieved.

The policy framework paper for the three years to come proposed a comprehensive adjustment program that his authorities endorsed, Mr. Cirelli continued. As Mrs. Hansen and Mr. Esdar had indicated, fiscal policy would be the cornerstone of the program. The planned reduction of the deficit for 1991 to 9.3 percent, as a consequence of a large set of measures taken recently, both on the revenue and the expenditure sides, was welcome, and reflected the extent of the Rwandese authorities' commitment. The effective implementation of that fiscal package would be crucial to the success of the program. Every effort to reinforce the implementation capacity of the authorities would be welcome.

Another key element of the 1991 program was the implementation of a restrictive monetary policy, Mr. Cirelli said. He noted with satisfaction that a wide range of measures had been envisaged to avoid a too large growth in the money supply. In that respect, he shared the concern expressed by Mrs. Hansen and Mr. Esdar that the level of interest rates should be carefully adjusted so that it remained positive in real terms. In any case, a rapid decline of the inflation rate would be needed.

The rigorous incomes policy followed by the authorities was particularly welcome, Mr. Cirelli said. While they were indispensable, the reforms would not be easy to carry out; he was therefore pleased with several of the initiatives taken to protect the most vulnerable group of the population.

With respect to external policies, Mr. Cirelli noted that the exchange rate adjustment in 1990 should, if supported by the strengthened financial policies he had described, improve the competitiveness of the economy and revitalize exports, particularly noncoffee agricultural exports and mining activities, which were essential to diversify Rwanda's exports. Following that large devaluation, efforts should be made to try to stabilize the exchange rate in order to support domestic financial policy.

Structural reform, and the long list of reforms undertaken in the program--reduction in trade and foreign exchange restrictions, tax and tariff reforms, liberalization of pricing policies, and public enterprise reforms--paved the way for a more competitive environment, which was the prerequisite for the success of any efficient adjustment process, Mr. Cirelli stated. He welcomed that approach and stressed the important role that the World Bank had to play in that area.

In that context, Mr. Cirelli said, and given the commitment of the authorities to embark on a program supported by the Fund, Rwanda had already received adequate financial assistance, on a commitment basis, from multilateral and bilateral donors, to bridge the outstanding financial gap for 1991. For their part, his authorities had already provided balance of payments assistance of $12.3 million to Rwanda, and the first disbursement would be made in the coming weeks.

It was obvious that a great deal depended upon the stabilization of the internal situation. Noting Mr. Koissy's encouraging statement, he hoped that a return to peace and a solution to the refugee problem would take place rapidly, in order to reinforce and ensure the success of the program.

Mr. Ichikawa made the following statement:

> The fundamental problem confronting Rwanda's economy has been the lack of corrective measures to deal with the sharp deterioration in the terms of trade. In fact, the authorities responded to the worsening in the current account balance by tightening import and exchange restrictions, while leaving the fiscal imbalance and exchange rate distortion unchecked.
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> The proposed structural adjustment facility program represents a first step toward comprehensive adjustment; however, considerable uncertainty is expected owing to security-related problems. Furthermore, diversification of the economy will require long-term structural adjustment efforts. That being said it is essential at this stage to support the new exchange rate policy with a timely and sufficient tightening of financial policies.
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> Turning to the first-year program, we commend the authorities for their strong prior actions in the fiscal and external area, while we note a decline in the ratio of revenue to GDP, despite the new tax measures. The progress toward price liberalization is

also welcome. Furthermore, the authorities are committed to a strong incomes policy; nominal public wages will be frozen and wages and salaries subjected to a new temporary tax. The interest rate structure was simplified and is being progressively liberalized, although the real interest rate is highly negative and a positive real rate should be achieved at the earliest opportunity.

All in all, the program before us would be a strong one if it were not for the extraordinary fiscal burden of security expenditures. Nevertheless, we are concerned about certain downside risks, including the volatility of coffee revenue. Uncertainty is also inherent in security-related costs. The success of adjustment depends largely on the early restoration of peace. On this point, I welcome the encouraging news given by Mr. Koissy.

It should be noted, however, that the deterioration in the fiscal balance started even before the war, and transfers to public entities were a major cause of the fiscal imbalance. While we welcome the fiscal package, including the elimination of budgetary transfers to the coffee sector, reform of the coffee sector and other public enterprises has been disappointingly slow. Improved management of the parastatals and their liquidation, if necessary, will be required at the earliest opportunity. If the parastatals continue to rely heavily on monetary financing through the banking system, monetary adjustment will be undermined considerably.

We are also concerned about the rather high inflation targets during the program period. In particular, a rate of inflation of 28 percent in 1991 may add renewed pressure to the current exchange rate. In this connection, I would appreciate the staff's comments on the degree of upfront devaluation in November 1990; namely, was the new rate intended to be nominally targeted through 1990, or for much longer?

In conclusion, the authorities have taken on major challenges in macroeconomic and structural reform in adverse circumstances. We hope that their upfront program implementation will establish a strong adjustment momentum, despite the external and internal difficulties.

Mr. Hogeweg remarked that as he understood it, the November devaluation had been justified in view of earlier developments. Chart 1 in EBS/91/61 was striking, in the sense that it showed that the real effective exchange rate over the past five years had been virtually constant, albeit at an overvalued level. In that light, he wondered whether the staff was justified in commenting, in its appraisal, that the rate of inflation remained low, largely owing to the overvaluation of the exchange rate. Was it not the stability of the exchange rate peg to the SDR that led to relatively low inflation, rather than the level at which it was stable?

He also wondered exactly how the new exchange rate policy had been announced, Mr. Hogeweg said. On page 10 of the staff report, it was stated that the Government would review exchange rate policy periodically, for instance, in the light of developments in the balance of payments and foreign reserves. He would have thought that a public announcement that Rwanda's foreign reserve position would be taken into account in managing the exchange rate might well give rise to speculative movements if the market was able to discern those reserve developments. He did agree with those who had said that it might be useful, after the devaluation, to revert to exchange rate stability, and certainly to an announcement of that policy, in order to prevent inflationary expectations from taking hold.

Ms. Lindsay-Nanton said that as she was in broad agreement with the staff appraisal and the comments made by previous speakers, she would limit her comments to points of emphasis and clarification.

The Rwandese population growth rate of 3.7 percent per annum, and the program's projection that per capita GDP was only expected to begin to increase by the third year of the program, were extremely discouraging, Ms. Lindsay-Nanton noted. The policy framework paper contained a general commitment to address that problem, and she wondered whether the staff could provide some details of the authorities' policies and assess their likely effectiveness.

The authorities' fiscal targets were also a concern, since they appeared to depend heavily on expenditure cuts rather than on tangible revenue measures, Ms. Lindsay-Nanton added. Moreover, while civil service salaries were being frozen, in the face of a projected 28 percent inflation rate for 1991 and a new wage tax, the program included allowances for substantial increases in military expenditure. However, in light of what Mr. Koissy had said, and assuming that the cease-fire held, perhaps the staff could comment on what the anticipated savings on military outlays were likely to be in 1991. The staff might also wish to assess the appropriateness and the likely long-term impact of the substantial decline in real civil service salaries projected in 1991.

As for monetary policy, the staff report included a discussion of the authorities' commitment to increase real interest rates to positive levels by the end of 1991, Ms. Lindsay-Nanton observed. Given the inflation projected for 1991, and the desire to move toward market-based instruments of monetary policy, could the staff indicate why a delay in adjusting real interest rates was felt to be necessary?

Finally, while the authorities had undertaken a substantial devaluation at the end of 1990, the staff report suggested that they would continue to monitor the competitiveness of the Rwandese economy, suggesting that further devaluation might be contemplated. Indeed, there seemed to be evidence to suggest that that would be required. In particular, the staff report referred to a recent study that called for a devaluation of at least 40 percent, and it appeared that the inflation expected in 1991 would substantially erode the competitiveness gained since November. Given the authorities' choice of an exchange rate peg, it seemed preferable to avoid a series of devaluations, and she wondered whether the 1990 devaluation had been of sufficient magnitude to avoid that possibility.

The Executive Directors agreed to resume the discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/91/61 (4/23/91) and EBM/91/62 (4/24/91).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 90/87 and 90/88 are approved.

APPROVED: November 26, 1991

LEO VAN HOUTVEN
Secretary