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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/158

10:00 a.m., December 16, 1981

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

Executive Directors	Alternate Executive Directors
M. Abdollahi	
	J. F. Williams, Temporary
	J. L. Feito, Temporary
	O. Üçer, Temporary
B. de Maulde	A. Le Lorier
R. D. Erb	
M. Finaish	
	Y. Okubo, Temporary
	R. J. J. Costa, Temporary
	M. Casey
	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
S. Kiingi	J. M. Jones, Temporary
	G. Winkelmann
	C. P. Caranicas
S. Nana-Sinkam	
	A. S. Jayawardena
	S. El-Khouri
	A. Halevi, Temporary
	B. Legarda
	L. Vidvei
Zhang Z.	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; A. Basu, E. L. Bornemann, R. O. Carstens, R. E. Daumont, I. A. H. Diogo, J. W. Kratz, R. Pownall, D. E. Syvrud, W. B. Tshishimbi, U. Wilson. European Department: J. Perejoan-Mustaros. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director. Fiscal Affairs Department: F. L. Corfmat. IMF Institute: S. Akakpo, Participant. Legal Department: R. C. Effros, S. A. Silard, J. V. Surr. Middle Eastern Department: A. K. El Selehdar, Deputy Director; G. T. Abed, S. H. Hitti, S. Thayanithy. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, C. Bouchard, A. B. Diao, M. A. Janjua. Assistants to Executive Directors: H. Alaoui-Abdallaoui, L. Barbone, M. K. Diallo, F. Guena, Jiang H., P. Kohnert, J. E. Leimone, V. K. S. Nair, J. G. Pedersen, C. N. Pinfield, J. Reddy, D. I. S. Shaw, H. Suzuki, A. A. Yousef.

1. TOGO - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Togo (SM/81/230, 12/2/81; and Sup. 1, 12/15/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in Togo (SM/81/231, 12/4/81).

Mr. Nana-Sinkam made the following statement:

> I would like to express my thanks and my authorities' appreciation to the staff for their well-balanced and excellent analysis of Togo's economic situation in SM/81/230 and SM/81/231. Since the comprehensiveness of the staff report leaves little room for a lengthy statement, I would like to concentrate my comments on some of the basic thinking underlying my authorities' policy stance.
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> For many years, the Government has striven to increase revenues in face of growing expenditure as shown in Table 3 of SM/81/230. The trend of government expenditure clearly shows that an important effort has been made; it is demonstrated by the fact that between 1978 and 1981 the ratio of budget expenditure to GDP decreased and government expenditure other than debt servicing stagnated in real terms, notwithstanding the increases in the cost of living, the recurrent costs of economic and social infrastructure, and the rise in the total cost of running the Government. Even the ratio of government deficict to GDP has declined, while the ratio of debt service to GDP has increased substantially. Unfortunately, Table 3 shows that in Togo, as is the case for the majority of non-net oil exporting developing countries, the ratio of government revenue to GDP has remained stagnant, leading to a larger government deficit than was projected.
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> The stagnation of government revenues despite the different measures taken to broaden the tax base, raise the tax rates, and improve the tax administration--which have brought the tax/GDP ratio to nearly 30 per cent--is a clear indication that the present economic structure of the country cannot yield revenue at the pace that was projected.
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> On page 1 of the staff report (SM/81/230) it is said that "severe financial imbalances developed in the Togolese economy when a short-lived phosphate boom induced the authorities to adopt expansionary policies, which were maintained long after the financial means were no longer available." This statement is only partially accurate. Saying that severe financial imbalances developed in the Togolese economy when a short-lived phosphate boom induced the authorities to adopt expansionary policies is unquestionably true. But adding that the expansionary policies were maintained long after the financial means were no longer available does not give the real picture. After investments were made during the period of the expansionary policies, the recurrent costs linked to those investments

became a painful heritage for the country. There is no doubt that it would cost the authorities more to abandon some of those projects, particularly those in the social sectors, such as health and education. The lesson the country has learned is that developing countries are price-takers on the world market for their exports and can project their income from exports only with a very high risk.

On page 11 of SM/81/230 it is stated that "the targets for 1981 under the financial program were to reduce the external current account deficit from 13 per cent of GDP to 9 per cent, to obtain a gross inflow of concessionary capital equivalent to 11 per cent of GDP, to amortize external debt in an amount equivalent to 5 per cent of GDP, and to limit the overall deficit to about 3 per cent of GDP." In retrospect, this commitment by the Togolese authorities appears to have been too optimistic in the sense that they did not take into account the fact that they are price-takers on the world market for their three major export products--phosphate rocks, cocoa, and coffee--which represent nearly 70 per cent of Togo's total export receipts. Despite continuous efforts to reduce the level of imports (at the cost of losing revenue from customs duties), the current account deficit increased by more than had been projected. The impact of such unfavorable developments on the external sector was detrimental for the overall economic situation of the country.

On page 12 of SM/81/230 it is stated that "in 1983 there is a bunching of debt service obligations which may call for a new rescheduling. This was agreed in principle by the major creditors of the Paris Club." It should be noted that this agreement was contingent on the successful implementation of the adjustment program concluded with the Fund. Therefore, the country finds itself in a dilemma, being confronted with the necessity of making new strong adjustments in order to return within the ceilings, or to conclude a new stabilization program with the Fund and comply with the realities of the present economic situation.

The question may be raised whether the rhythm of adjustment was not too fast for the country's economic structure to handle, or whether another pace of adjustment could not have made the sacrifice more bearable. Could another cycle of adjustment leading to a medium-term improvement in the trend of economic adjustment, rather than a consecutive yearly improvement in the trend, be less burdensome for the authorities? In other words, for some cases, could a year of sharp improvement be followed by a less dramatic one, still yielding a trend of general improvement?

One thing is certain: with or without the Fund, Togo has to adjust. Let me therefore make it clear that I am not questioning the appropriateness of the staff judgment; I am only reflecting on the type of lessons that can be drawn from the implementation of the present adjustment program, which happens not to be an isolated case.

Despite the difficulties being experienced by the country, the authorities still believe strongly that the successful outcome of any effort to lay down the basis for a sound development process hinges not only on their continued adherence to strict financial policies, but also to an important extent on economic developments abroad. Consequently, the present difficulties, some of which result from factors beyond the authorities' control, do not deter them in their determination to hold to their medium-term and long-term adjustment policy and to benefit from the Fund's advice and assistance.

Mr. Nana-Sinkam added that in the period 1978-81, the budgetary situation had been improving. The Fund's experience with Togo suggested that a further look should be taken at the wisdom of using a decline in the budget deficit as a performance criterion for certain member countries. It was important to look at the reasons for the budget deficit in nearly every case; many countries had no choice but to incur expenditures for such projects as hospitals and schools. Accordingly, the Fund should perhaps emphasize the need to adjust current budgetary expenditures rather than investment expenditures made through the budget.

Mr. de Maulde said that he broadly agreed with Mr. Nana-Sinkam. Togo was obviously facing difficult external and internal economic problems, but the budget performance criteria that had been agreed with the authorities were probably not realistic. The financial program for 1981 had provided for capital expenditures of only CFAF 4 billion, less than half the amount that had actually been spent in 1980. On the revenue side, the projections had apparently been overoptimistic; the contribution by the Phosphate Board and Agricultural Marketing Board had been much lower than expected. He fully agreed with Mr. Nana-Sinkam that there was considerable risk in estimating developing countries' income from exports, as could be seen from the excessively optimistic projections for the revenue of Togo's Phosphate Board.

The staff had correctly concluded, Mr. de Maulde considered, that a major overhaul of the state enterprises was called for, but it had said relatively little about specific ways of improving them; their management clearly needed to be reviewed, and some of them could perhaps be eliminated. There was some feeling that further development of the private sector was crucial for the Togolese economy; but he doubted whether the agricultural sector could make a significant contribution to improving the revenue or balance of payments positions. It would be useful to know whether the World Bank planned to take any steps to help Togo improve the state enterprises. Finally, he wondered whether any progress had been made on a program for 1982 in support of a stand-by arrangement, particularly in the light of the recent rescheduling of Togo's debt through the Paris Club.

Mr. Erb commented that the staff had clearly described the various problems facing the economy. He wished to respond to the issues of Fund policy that Mr. Nana-Sinkam had raised when he stated that, while he did not question the appropriateness of the staff calling for further adjustment in Togo, he did wish to encourage the Executive Directors to reflect on the type of lessons that could be drawn from the implementation of Togo's present adjustment program. Having participated in several discussions of staff reports for Article IV consultations with other African countries, he was worried that the financial program traditionally favored by the Fund, which emphasized macroeconomic performance criteria, might not be an adequate or sufficient--although necessary--way of approaching those countries, many of which had to deal with problems similar to those facing Togo. One of the problems had been that medium-term budgetary difficulties had been created by surges of investment in major industrial or raw material projects. Another important problem had been the lack of adequate management of public enterprises. Furthermore, weak pricing policies had adversely affected resource allocation in a number of African countries. The staff should be asked to take a broad look at the Fund's experience with financial programs in African countries to learn whether a somewhat different approach might not be called for in the future, particularly with respect to the microeconomic factors affecting the countries' overall balance of payments position.

Mr. Winkelmann said that he broadly agreed with the thrust of the staff analysis. There was clearly a substantial financial imbalance in Togo as a result of the poor market for phosphates, mismanagement of the state enterprises, slippages in government spending, an inadequate tax system, and excessive reliance on a small number of primary products. The external debt had become difficult to control, payments arrears had accumulated, and since 1979 per capita income had been sinking to the present extremely low level.

The problems facing the economy, Mr. Winkelmann commented, were traceable in part to the boom begun in the 1970s in the wake of the sharp increase in revenues from phosphates, and in particular the ambitious investment program that had proved to be unrealistically large after the decline in the market for phosphates. Mr. Nana-Sinkam seemed to feel that the staff's judgement was rather harsh, but at one point the level of investment had reached the equivalent of 40 per cent of GDP, thereby unbalancing the economy. The World Bank was now heavily involved in the effort to bring the development program back on track. The Fund had tried to help by lending assistance under a stand-by arrangement, and the current account deficit had been reduced from the equivalent of 20 per cent of GDP to 13 per cent. However, recently the treasury deficit had risen sharply, and the budget deficit appeared to be growing at a striking rate.

He agreed with Mr. de Maulde, Mr. Winkelmann continued, that it was crucially important to see whether the deficits of the state enterprises could not be reduced, although it was difficult to know whether first priority should be given to that effort or to a program for strongly increasing investment in the traditional sectors, particularly agriculture. In that connection, he agreed with Mr. Erb that greater attention than hitherto should be paid to the microeconomic elements of the situation in Togo. For instance, had the country lost domestic and foreign markets directly as a result of the stagnation of domestic enterprises?

Monetary policy had been excessively accommodating, Mr. Winkelmann considered, and payments arrears had begun to accumulate. It was admittedly difficult to know precisely which course of economic policy was appropriate for a very small economy like Togo's. However, there was clearly a strong dependence on cocoa and coffee exports, and he wondered whether it would not be useful to change the tax system to increase the emphasis on more regular sources of revenue, including perhaps an excise tax. The staff had noted that Togo was still experiencing difficulties with data collection; the problem seemed to have added to the difficulties in properly managing tax collection as well as in planning and implementing the investment program. Togo could make effective use of technical assistance in the preparatory stages of its adjustment and development efforts, and, in that connection, both the Fund and the World Bank could be helpful.

At the present stage, Mr. Winkelmann said, it was difficult to know whether or not the performance criteria had been excessively ambitious, but presumably both the authorities and the staff had felt that the criteria would prove to be feasible. It was of course up to the authorities to implement the performance criteria and to say when they felt that circumstances made particular criteria difficult to meet. Developments in the world markets for Togo's exports were a possible source of the difficulties that the country had had in meeting the performance criteria. Did the staff feel that the performance criteria had been excessively ambitious, or that unexpected events had made it hard for the authorities to observe all of the performance criteria? Certain technical improvements in the Government's implementation and managerial capacity would help the authorities to consolidate the benefits of ongoing investment projects, introduce an appropriate new investment program, and find the proper balance between the use of domestic resources and financial assistance from the Fund and others.

Mr. Kiingi stated that he broadly agreed with the staff's assessment of the Togolese economy, which had faced a number of difficulties in recent years: the rate of economic growth had dropped from 6 per cent in 1978 to 0.2 per cent in 1980 and minus 5.9 per cent in 1981; the budget had been burdened by large debt service payments; and the world market conditions for Togo's exports had not been favorable. As a result, accumulated payments arrears had reached a critically high level. The financial program implemented in 1980 in support of a stand-by arrangement with the Fund had not improved the situation; the accumulation of payments arrears had continued in the first nine months of 1981, and the treasury deficit of approximately CFAF 8.6 billion in the first six months of 1981 was much larger than the CFAF 1.2 billion target.

He fully agreed with the staff, Mr. Kiingi continued, that a major adjustment effort in public finance was required. The tax burden was already large, and additional tax measures might well prove to be counterproductive; therefore, the major burden of adjustment would have to fall on expenditures. The authorities were fully aware of the problem and had begun the effort to streamline the budget; the development plan for 1981-85 had been scaled down, and the subsidies to state enterprises were to be reduced. In addition, monetary policy had been consistent with the objective of reducing the external payments deficit, although the private sector had been particularly burdened by the credit restrictions; if the private sector was to be a major contributor to economic growth, the authorities might have to review their credit policy. They clearly wished to reduce the payments arrears and to improve the country's debt profile, but their efforts had been largely frustrated by the unfavorable developments in the world markets for Togo's exports. In the circumstances, if economic growth was to resume, there would have to be an inflow of capital on concessional terms.

The staff representative from the African Department commented that the authorities maintained a rollover system for unused capital expenditures. At the time of the discussions with the authorities, there had been some CFAF 16 billion in accumulated unused capital expenditures under the rollover system. It had been felt that, since only CFAF 3 billion of that amount was to be used for ongoing projects, the limit under the financial program of CFAF 4 billion could be lived with. With the benefit of hindsight, however, the limit was probably unrealistic; capital expenditures were likely to reach CFAF 12 billion for the full year 1981. On the revenue side, the assumptions about the contribution by the Agricultural Marketing Board had not been overoptimistic; the Board had paid the full amount that had been expected--CFAF 6 billion for 1981 as a whole. The Phosphate Board had not made the full contribution that had been expected of it, but its performance had been relatively good; it was likely to contribute approximately CFAF 10 billion in 1981, compared with the budget estimate of CFAF 13.5 billion, the difference being due to the leads and lags in payments for exports following the deterioration in the world phosphate market. Togo had had to extend credit on a fairly large scale to purchasers of its phosphate exports; in the past it had usually been paid for exports within 3 months, but more frequently it had had to wait up to 12 months for payment, and some countries had failed to pay altogether. In the circumstances, the authorities had decided to mount an export campaign, and the President had led a delegation to Spain, Germany, and Turkey to encourage exports to those countries; indeed, the level of exports to those countries had risen in previous months. The depreciation of the CFA franc had helped to offset the deterioration in the world phosphate market.

The staff had deliberately refrained from making detailed recommendations on the state enterprises, the staff representative explained, mainly because in that area it had been relying on the work of the World Bank, which had recently completed an extensive study of the state enterprise sector. Some of the findings of the study had not been fully accepted by the Togolese authorities, and a World Bank mission had recently visited Togo to discuss the study's conclusions with the authorities. In discussing the state enterprises with the authorities the Fund staff had concentrated on the six largest unprofitable enterprises and had received assurances from the authorities that they intended to take steps to deal with each of them. One of them, a salt distillation plant, was to be closed down; another, a machine leasing company, was in difficulty and was to be reorganized after the completion of a study. Two other enterprises, a transport organization and a steel mill, were to be sold, or reorganized and partly sold if possible. The refinery was small and, under current conditions, could not operate profitably. It had been closed since March 1981 and there were no immediate prospects for reopening it; negotiations with the United Kingdom and other interested parties on the future of the refinery had been started. The large new hotel required considerable subsidization, and the Government had decided to seek new partners in the venture; as a result, part of the hotel ownership would probably be sold to foreign interests. A number of other, smaller state enterprises were well operated and profitable.

As for the nongovernment sector, the staff representative went on, agriculture had performed relatively well and the Agricultural Marketing Board had been making progress, as was reflected in its contributions to government revenues. The Board had already been paying fairly high prices to producers in Togo, but there seemed to be additional room both to increase output and to improve the budgetary position; the World Bank was beginning a study on the problems facing producers in Togo. The commercial sector, particularly the privately owned companies, was booming. Many state-owned companies had not done well, and the authorities hoped that the private sector's performance would continue to improve; they had given high priority to repaying the domestic arrears in order to provide sufficient liquidity for the revitalization of the private sector.

The staff discussions on a further arrangement with Togo had been held only quite recently, the staff representative explained, and considerable progress had been made. The staff and the authorities had agreed in principle on a financial program for 1982 and on certain actions to be taken before then, but the details still had to be worked out, particularly with respect to the budgetary situation in 1982, including expenditure control procedures and a time table for the adoption of measures to improve the state enterprises. The staff hoped to work the details out with the authorities early in 1982.

A technical assistance mission to Togo in 1977 had concluded that there was little room for further taxation, the staff representative remarked. The tax burden was already the equivalent of 30 per cent of GDP, a very high level by African standards, and fiscal policy would therefore have to concentrate on curbing expenditure; that had been the objective under the existing stand-by arrangement and would be so again under the 1982 program. The authorities had expressed an interest in receiving additional technical assistance in 1982, and the staff was now considering the matter.

The performance criteria under the existing stand-by arrangement had not been observed for a number of different reasons, the staff representative from the African Department commented. One of them was the deterioration in the world markets for phosphate, coffee, and cocoa; without the 23 per cent depreciation of the CFA franc in relation to the U.S. dollar, in which the three commodities were traded, the deterioration in the markets would have presented an even larger problem for the Togolese economy in general, and for the budget in particular. The inadequate expenditure controls in Togo and the rollover system for capital expenditures had also made it difficult for the authorities to observe the performance criteria. Those particular problems were long-standing and purely domestic in nature; they would be tackled within the framework of the next stand-by arrangement.

The Deputy Director of the Exchange and Trade Relations Department commented that Mr. Nana-Sinkam had raised the question whether the staff had not been concentrating excessively on the outcome of the overall budget position and had suggested that the staff should perhaps pay more attention to the current account. The staff examined every aspect of a member's budgetary situation, and it would be reluctant to emphasize the current account in setting a budgetary performance criterion for Togo. As the staff and Executive Directors had noted, Togo faced a serious external imbalance, and in concentrating its attention on current expenditures while paying insufficient attention to capital expenditures the staff would run the risk of designing an internally inconsistent program. In the light of the external debt situation, one of the adjustment tasks that Togo obviously faced was to make less use of nonconcessional capital inflows; in that connection, Togo would have to gear all expenditures, both current and capital, to the level of available resources.

The staff agreed with Mr. Erb that many of the problems facing Togo and other African countries were difficult to deal with under Fund-supported programs, the Deputy Director of the Exchange and Trade Relations Department continued. The staff would welcome suggestions from Executive Directors regarding possible ways of improving the Fund's approach to such countries.

Mr. Erb commented that although Togo's payments position had been adversely affected by developments in the world economy, the price for Togo's phosphate exports appeared to be excessively high. It was noted on page 7 of SM/81/231 that the average export price had increased substantially in the period 1977-81, and Table XV showed that the average export price per ton of phosphates had risen from $29.50 in 1977 to approximately $50 in 1980 and 1981. Assessing the price for phosphates was an example of the kind of microeconomic analysis that was needed for countries like Togo. A more flexible pricing policy might well enable Togo to increase both its phosphate exports and its budget revenues. In addition, the staff had suggested that some reorientation of phosphate production seemed to be called for.

The staff representative from the African Department commented that Togo's phosphate mine was one of the most productive in the world. Its production costs were very low--about $17 a ton--and the export price had always been quite remunerative; at present, the price was approximately $52 a ton. Togo's phosphate mine had encountered difficulties because phosphate buyers in Europe had recently begun to prefer to acquire processed phosphate; while some countries, such as Senegal and Morocco, had constructed phosphoric acid plants, Togo had been somewhat slow to act. The Togolese authorities were now trying to rectify that mistake; they were actively seeking financing to construct a phosphoric acid plant, but their efforts had been hindered by the high level of Togo's debt--which exceeded GDP--and the considerable cost of a new plant--approximately $300-500 million. The potential sources of finance in Europe and the United States required not only a guarantee by the Government but also a guarantee based on the output of the new plant. Production of phosphoric acid in Togo probably could not begin for some time. Meanwhile, the authorities had mounted an export drive in Western Europe after halting exports of phosphates to Eastern Europe, particularly to Poland--which had been the main buyer in that area--and Yugoslavia, both of which had failed to make payments on previous exports.

Mr. Casey said that it was his understanding that a considerable proportion of the total arrears of Togo were in the form of short-term commercial debt. Such debt was not covered by agreements under the Paris Club, and he wondered whether Togo would not continue to have a sizable problem with external arrears even with the debt rescheduling agreement reached under the Paris Club.

The staff representative from the African Department responded that the Paris Club dealt only with official debt; in the near future Togo could have a considerable problem also with short-term debt to private creditors, which was dealt with in the framework of the "London Club."

The Chairman observed that Table LI in SM/81/231 showed that debt service payments as a percentage of merchandise exports had risen alarmingly to 30.5 per cent in 1978, to 75.8 per cent in 1979, to 88.6 per cent in 1980, and an estimated 102 per cent in 1981. The debt ratio had been reduced by the agreement on rescheduling, but the country had clearly experienced an external shock in the period 1978-81, largely because of the excessive borrowing to finance the investment boom following the favorable developments in the phosphate market. Had those investments been productive?

Togo had succeeded in making certain adjustments in the economy under the stand-by arrangement for 1979-80, the Chairman continued, but no significant adjustment had been made in 1981. The external current account deficit had increased sharply in 1979, reaching the equivalent of 24 per cent of GDP, one of the highest ratios of the entire Fund membership; but it had fallen to approximately 13 per cent in 1980 and, at the same time, the treasury deficit had been cut in half to approximately CFAF 5.2 billion. The treasury deficit had, however, risen to an estimated CFAF 14 billion in 1981; as a percentage of GDP it had risen from 2.2 per cent in 1980 to 6 per cent in 1981. The target for the decline in the Treasury deficit in 1980 had been more ambitious than the target for 1981, but the 1980 objective had been achieved, while the 1981 goal had not. Hence, he hesitated to conclude that the 1981 fiscal target had been overambitious; given the large decline in the treasury deficit in 1980, it had not been unreasonable to expect a further decline in 1981.

The financial program for 1981 had emphasized fiscal adjustment, the Chairman went on, but it was precisely in that area that the greatest deterioration had occurred, and to improve the understanding of the operation of Fund-supported programs it was useful to consider why that had happened. One of the most ambitious targets had been the projected decline in capital expenditures to CFAF 4 billion in 1981, considerably less than the actual CFAF 12.8 billion in 1980. What kinds of cuts in capital expenditure had been expected in 1981, and why had they not actually been made? Indeed, not only had the projected cuts failed to materialize, but increases in capital expenditure had occurred; in such a case, the Fund staff could usefully explore with the World Bank staff the nature of the capital expenditure program to ensure that the problems in that area were fully understood. What was the World Bank's explanation of Togo's poor performance with respect to capital expenditures?

Another major factor in the slippage in the fiscal sector had been the decline in revenue in nominal terms, the Chairman noted. Actual revenues in 1981 were now projected at CFAF 63 billion rather than the program target of CFAF 69.2 billion; the actual figure in 1980 had been nearly CFAF 69 billion. The significant decline in public revenue had occurred despite the high rate of domestic inflation. It was true that the real rate of economic growth in 1981 of minus 5.9 per cent had adversely affected revenues, but it would be useful to know whether the tax system in Togo was sufficiently elastic, and whether specific steps should not be taken to improve the system. If such steps were not feasible, a closer look at the budget situation would be warranted. If the capital expenditures that the authorities now had in mind, particularly the investment in production of phosphoric acid, were to be productive, there would have to be restraint on current expenditure. Was excessive current expenditure the main cause of the budgetary problems in Togo? Was the size of the public service excessive, and had an effective public employment policy been adopted?

The staff representative from the African Department commented that the huge investments in the late 1970s had not been productive; indeed, they were a major factor in the deep-seated problems that faced the Togolese economy and which would probably continue to cause a decline in GDP for some time to come. One of the major investments--the CFAF 40 billion hotel--had been speculative in nature; a luxurious building, it had been designed to attract international conferences but had failed to do so as yet. In its first year of operation the occupancy rate of the hotel had been just 20 per cent and losses of CFAF 1.4 billion had been incurred. The other two major investments, the refinery and the steel mill, had been made prior to the unforeseen increase in the price of oil imports. The refinery had been closed and there was little likelihood that it would become productive. As for the steel mill, it had never worked above 15 per cent of capacity, and the World Bank doubted whether it would ever become profitable. Those three investments helped to account for the high debt service ratio and the accumulation of arrears.

Reducing the unduly high level of capital expenditures had been one of the main features of the adjustment effort in Togo, the staff representative continued, and the authorities and the staff had agreed that the effort should be made without excessively harming ongoing projects. With the benefit of hindsight, the staff felt that the effort had been overambitious. The period of the rollover system had been limited to three years, but CFAF 16 billion in unused expenditures had accumulated in that time and CFAF 4 billion in new allocations had been agreed, thereby increasing the potential level of capital expenditures to CFAF 20 billion, although CFAF 12 billion had actually been spent in 1981. Indeed, when the staff had raised the matter with the authorities, they had expressed pride in having limited capital expenditures in 1981 to CFAF 12 billion; they had not been at all disappointed in their performance.

The World Bank staff, however, had been surprised by the still relatively high level of capital expenditure in 1981, the staff representative commented. It also had concluded that the present development plan, which called for CFAF 250 billion in new investment in the economy over five years, was unrealistic. The World Bank staff and the Togolese authorities had drafted an interim development plan that provided for sizable cuts in investment, although the passage of time had made it unrealistic too. As a result, for the moment the Government had neither a viable development plan nor an agreed list of projects. In fact, several unforeseen projects had been started without either feasibility studies or consultation with the World Bank and the Fund. Those investments accounted for the unexpectedly high level of capital expenditure in 1981 and underscored the need to correct the institutional deficiencies, as the staff hoped to do under the financial program for 1982.

The decline in revenues and the unexpected increase in capital expenditures accounted for the large increase in the budget deficit in 1981, the staff representative remarked. The tax system in Togo was relatively elastic. There had been a revenue shortfall of CFAF 2 billion following the stagnation of private sector activity and the decline in turnover tax receipts, and there had been a CFAF 3-4 billion decline in tax receipts from the Phosphate Board. On the expenditure side, public sector salaries had clearly become a problem, largely because the Government of Togo, like the governments of other West African countries, had become the employer of last resort, taking on all graduates of vocational schools and universities. As a result, the level of employment in the public sector had doubled in the previous five years, reaching 41,000 persons, and was expected to rise further. The authorities continued to feel that failing to employ persons who had become highly trained at government expense constituted a serious waste of resources.

Mr. El-Khouri, comparing fiscal performance in 1981 with that of 1980, remarked that it was not unusual for a government to be able to maintain a tight fiscal policy for only a limited period. In the case of Togo, the authorities had made significant adjustments in 1979 and 1980 but had probably overshot their expenditure target in 1981 in order to compensate somewhat for the previous period of restraint.

The Chairman said that basically he agreed with Mr. El Khouri. However, in the case of Togo, whose debt exceeded its GDP, the authorities had no choice but to maintain the adjustment effort. The main question raised by Togo's recent experience was what kind of program would best contribute to the country's adjustment effort.

Mr. Winkelmann noted that the treasury deficit had been CFAF 9.7 billion in 1979, and CFAF 5.2 billion in 1980, and the portion of the overall deficit covered by external financing had been sharply reduced, from 18 per cent in 1979 to minus 2 per cent in 1980. At the same time, some of the central bank borrowing to finance the deficit had been repaid, as was reflected in the decline in the ratio of central bank borrowing to the overall deficit from 35 per cent in 1979 to minus 45 per cent in 1980. Furthermore, the increase in the rate of domestic credit had risen from 6.5 per cent in 1979 to 19.3 per cent in 1980, and the rate of increase in money and quasi-money had risen from 4.2 per cent in 1979 to 9.2 per cent in 1980, while the rate of increase of claims on the private sector had fallen from 14.4 per cent to minus 0.2 per cent. Hence, the figures on central government finance suggested that central bank borrowing had been repaid, thereby implying a decline in the monetary base, while the figures on money and credit painted a different picture.

The staff representative from the African Department responded that at the end of 1980 the Central Bank had turned over to the Government some CFAF 2.8 billion in profits, thereby changing the financing picture for the year.

Mr. Erb said that he was uncertain whether the Chairman had meant to question the basic performance criteria targets for Togo or the structure of the financing program for 1981, particularly its focus on fiscal policy. In a small economy like Togo's, a change in one or two variables could throw the entire adjustment program off course. The main question raised by the recent experience in Togo was how to design a program that could deal with the fundamental problems facing the economy.

The Chairman responded that the Togolese Government should be making significant adjustments in the economy; although it had made important adjustments in 1980, it should not relax the effort in 1981 and 1982. Despite the existence of a stand-by arrangement, the necessary adjustments had not been made in 1981. It had been impossible to know whether the institutional structure was adequate, and the authorities themselves were under the impression that their performance with respect to investment expenditures in 1981 had been quite good. To help prevent such misunderstandings between the staff and the authorities, the World Bank could help to review the country's microeconomic decision-making process; the Fund staff was not in a position to help the authorities establish priorities for individual projects. When a financial program supported by the Fund emphasized the effective implementation of relatively few decisions on capital projects, the Fund should have a mechanism that, with the cooperation of the World Bank, would keep slippages in capital expenditures from occurring. Furthermore, while the staff had paid close attention to the overall effects of the investment projects in Togo, it should also pay sufficient attention to the current account of the budget. Although they were admittedly difficult to implement, measures to curb current expenditures, particularly on public administration, might be needed if the Fund was to help the Togolese authorities address the fundamental problems facing the economy.

Mr. Nana-Sinkam considered that, in assessing the performance of the current account in the budget, Executive Directors should carefully note the structure of the account and the factors that had caused the deficit to increase. Exports had risen to SDR 266 million in 1980, compared with SDR 206 million in 1979; at the same time, imports had declined from SDR 336 million to SDR 317 million. Hence, the conditions for adjustment in 1980 had been quite favorable. In 1981, however, exports had declined to SDR 182 million while the need for imports had continued to be substantial. The trade performance underscored the fact that it was very difficult for developing countries like Togo, which were price-takers, to make sizable economic adjustments. As for the revenue performance, approximately half of government revenues were derived from import duties, and the declining trend in imports in recent years had been an important factor in the fall in revenues, which had added to the difficulties in making needed adjustments in 1981.

The question whether the pace of adjustment in Togo had been appropriate had wisely been raised by Mr. El-Khouri, Mr. Nana-Sinkam recalled. It seemed likely that the pace had been excessively fast in the initial stage, thereby quickly exhausting the country's capacity for adjustment; a more gradual approach would probably have been better.

The target for capital expenditure under the 1981 program was CFAF 4 billion, Mr. Nana-Sinkam noted, and the most recent estimate of actual expenditures was CFAF 12 billion. In anticipating a level as low as CFAF 4 billion the staff might have underestimated the need for expenditure to maintain the kinds of investment projects that the Government had already undertaken, particularly the new hotel, which required large sums for maintenance. Moreover, full account apparently had not been taken of the adverse effects of the fluctuations in the exchange rate on the performance of the domestic economy; for instance, the depreciation of the CFA franc had significantly increased the cost of servicing Togo's external debt.

He fully agreed with Mr. Erb, Mr. Nana-Sinkam went on, that the time had come to take a fresh look at the kind of Fund-supported adjustment program that was appropriate for sub-Saharan African countries. A number of the programs had been unsuccessful; many of them had worked well for the first year or so but had subsequently fallen apart. It was true that, in some of the countries concerned, the mechanisms for allocating resources were inefficient, but many of the countries were price-takers for their main exports, so that merely increasing the prices offered to domestic producers did not necessarily result in an increase in exports. In a recent case that was typical of sub-Saharan Africa, a member country had produced a large coffee crop but had been unable to export all of it because of the provisions of the International Coffee Agreement. In any event, in the particular case of Togo, it was incorrect to imply, as the staff had done, that in 1981 the authorities had continued the excessive public expenditure that had been evident during the investment boom in earlier years. In fact, the recurrent costs of certain projects had significantly increased, and the scope for improving the fiscal performance was limited. Togo naturally wished to reduce the level of imports, particularly of luxury goods, but it was precisely that category of imports that made the largest contribution to tax collections. Similarly, income tax revenues had been limited by the decline in export prices and by the continued low level of income in Togo, including earnings by civil servants. The burden of taxation in Togo had already reached 30 per cent of GDP, and additional taxes would probably be counterproductive.

In considering whether or not the performance criteria in 1981 had been excessively ambitious, Mr. Nana-Sinkam commented, Executive Directors should bear in mind that many developing countries had no choice but to introduce a Fund-supported stabilization program. For instance, Togo's major creditors had said that they would not agree to debt relief under the Paris Club unless the Government first reached an agreement with the Fund.

Commenting on expenditure control in Togo, Mr. Nana-Sinkam said that the best approach was to emphasize expenditures that the Government could most easily control. In Togo, current expenditures had been easier to control than capital expenditures. As the Chairman had suggested, the Fund had to rely on the World Bank staff for full information on specific capital expenditures in certain member countries.

He agreed with the staff, Mr. Nana-Sinkam remarked, that Togo clearly had a need for additional inflows of capital on favorable terms. However, such inflows were not fully within the control of the authorities themselves.

Mr. Erb said that he continued to feel that the relatively high price for the phosphate exports of Togo had hurt the overall export performance. The information provided by the staff suggested that, given the need to shift the orientation of phosphate production in Togo, and in the light of the rise in the price of phosphates in the previous three years, a more flexible pricing policy for that particular commodity could have resulted in an increase in phosphate exports and a corresponding decline in the external current account deficit. The table on page 21 of SM/81/230 showed that phosphate exports had declined in the first six months of 1981.

The Chairman made the following summing up:

The Executive Directors have indicated broad agreement with the thrust of the views expressed in the staff appraisal. They noted that, in spite of high public investment expenditures, growth had been negative in two consecutive years. The efforts to improve the weak public finance position had not yet met success and the external debt was extremely high.

They expressed particular concern about the budget performance in 1981 and noted that a major adjustment effort would be required. They urged the authorities to tighten budget policies, particularly on the expenditure side, and to adopt without undue delay a comprehensive presentation of the budget, including all investment expenditures. The rollover system for capital expenditures should be reviewed, too, because it has been one of the main reasons for the larger than programed treasury deficits and thus for the buildup of arrears. The rise in external arrears has reached critical proportions. In my view, that may have a detrimental effect on Togo's credit standing, and every effort should be made to reduce and, in due time, eliminate those arrears.

Directors particularly stressed the need to improve the financial management of public enterprises with a view to enhancing their efficiency and reducing the drain they exert on the budget. It is also clear that the growth of current government expenditures will have to be pruned. Finally, let me add, as a personal comment after our discussion, that the decision-making process regarding capital expenditures needs to be improved urgently, and we will be working with the Togolese authorities and the World Bank in that direction.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with Togo, in the light of the 1981 Article IV consultation with Togo conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Togo continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 7012-(81/158), adopted
December 16, 1981

2. UPPER VOLTA - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Upper Volta (SM/81/212, 11/4/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in Upper Volta (SM/81/224, 11/27/81).

Mr. Nana-Sinkam made the following statement:

> At the outset, I would like to convey to the staff the appreciation of my authorities in Ouagadougou for the excellent papers on the current economic and financial situation in Upper Volta. My authorities have no major difficulties with the staff analysis and appraisal, which they found to be comprehensive and well balanced.
>
> Upper Volta is a landlocked country and one of the least developed nations in the world, with a per capita GDP of SDR 170; it has practically no known mineral resources. Hence, it faces an extremely difficult challenge in its quest for economic development. To fully appreciate the difficulties in this struggle for economic growth and development, one must bear in mind the adverse circumstances under which economic activity takes place, namely, the vagaries of the Sahelian climate, with its limited and erratic rainfall and persistent drought conditions, which make agricultural production extremely unstable. These adversities of the Sahelian climate, plus the unfavorable developments in the world economy during the past several years, have seriously hindered economic activity in Upper Volta.
>
> The pace of economic growth has been extremely timid over the past decade; real GDP rose by an average of only 0.9 per cent a year. In the face of a rate of population growth of 2 per cent, this has meant a quasi-stagnation of the living standards of Upper Voltans.
>
> Despite all the odds against them, the Upper Voltan authorities are determined to pursue policies that are conducive to stronger economic growth and to the overall improvement in the living standards of the population at large.
>
> With respect to development policies, the emphasis will continue to be on the rural sector and on setting up the required infrastructure for transportation and communication between all parts of the country. These policies are to be spelled out in the next development plan, to begin in 1982. A draft of the plan will be completed in the coming months, with technical assistance from the World Bank. The authorities are contemplating the establishment of a National Public Investment Fund with a view to improving planning and investment activities. A report on this matter has been submitted to the authorities by the World Bank, and positive action by the Government is expected to be taken very soon.

In agriculture, top priority has been given to the achievement of self-sufficiency in food production as well as to the expansion of the production of export crops, such as cotton and sheanuts. The authorities have undertaken a vast program consisting of small irrigation schemes, mainly for rice production. The authorities are also stepping up their efforts to promote the use of modern farming techniques, such as animal traction, fertilizers, and new seed varieties. They are also committed to promoting an integrated rural development at the regional level through the improvement of the extension services provided by the public regional development agencies. Now that the problem of river blindness has been brought under control thanks to the World Health Organization, the Food and Agriculture Organization, and the World Bank, the authorities have undertaken programs to resettle the fertile valleys of the Volta River. These programs, although costly and slow, are much welcome, as they will undoubtedly contribute to the expansion of the agricultural productive capacity of the Upper Voltan economy.

In mining, prospecting will continue, and the development of the sector will be undertaken within a regional framework involving Niger, Mali, and Togo. It is in this context that the four states participating, including Upper Volta, have set up the Liptako Gourma Development Authority, which is responsible for all aspects of mineral exploitation and commercialization. The authorities involved are actively seeking external financing for the various mining projects thus far identified.

With respect to project implementation, a serious bottleneck arises from the lack of domestic resources to cover the local contribution to project financing. The authorities have raised the problem with the main aid donors, and some success has been achieved in the form of a reduction of the amount of local contribution to project financing that is normally required.

With respect to financial policies, it will be recalled that the authorities adopted a one-year financial program ended in June 1980 which was supported by a Trust Fund loan in the second period. The objective under this program was to reduce the balance of payments deficit to SDR 6.5 million. The policy measures taken in support of the program's objective were implemented successfully.

In the fiscal field, the authorities' objective remains the reduction of the overall budgetary deficit from the equivalent of 9 per cent of GDP in 1979 to a much lower and sustainable level. This result will be achieved essentially through tighter government expenditure control and better tax administration. The authorities succeeded in reducing the deficit to the equivalent of 4.8 per cent in 1980. On the revenue side, significant efforts have been made to improve tax collection and administration through the restructuring of the Tax Directorate, the establishment of a tax enforcement unit in each regional administrative section, the simplification of tax return forms, the strengthening of the enforcement capacity of the customs machinery, and the introduction of tax payment certificates for all business transactions. Moreover, the adoption in January 1981 of a new comprehensive turnover tax within the framework of the West African Economic Community will in all likelihood eliminate the problem of tax evasion. New tax measures have been introduced for 1982 and will be applicable to both the formal and informal private sector. The overall objective of the authoities is to make the tax system more efficient and equitable. On the expenditure side, no general salary and wage increases were scheduled for 1980 in the public sector, and the authorities hedged against such probable increases early in 1981 by freezing the level of government employment and military personnel at the 1980 level.

The authorities are fully aware of the need to integrate all government transactions into the normal budgetary framework to ensure more efficient financial planning and control. They hope to fulfill this need through the creation of the Investment Fund. The authorities also intend to significantly reduce government recourse to the banking system. They are fully aware that their success in attaining a more viable budgetary position depends partly on the performance of the public enterprises. It is in this context that emphasis will be placed on improving the performance of the enterprises, and technical assistance in this field is being sought by the authorities.

In the monetary field, the authorities intend to continue their tight policy stance. Credit policy will remain tight, although the authorities will make sure that the needs of the productive sectors of the economy are met.

In the external sector, the upward trend in export activity observed in 1979 and 1980 is expected to continue in 1981 and 1982, thanks to a good performance of the agropastoral sector. However, the overall balance of payments is expected to show a slight deficit of SDR 1.5 million (CFAF 0.5 billion) in 1981 and a larger one of SDR 16.8 million (CFAF 5.6 billion) in 1982, on account of rising import costs and a deterioration in Upper Volta's terms of trade. The major concern of the Upper Voltan authorities is to bring about an adequately high level of economic growth while ensuring both external and internal financial stability. It is in this context that they are considering adopting in 1982 a stabilization program to be supported by Fund resources from the extended financing facility. Discussions relating to such a program will begin when the next Fund mission visits Ouagadougou, in early 1982.

Mr. de Maulde commented that, while Upper Volta apparently did not suffer from any major economic imbalance, some adjustment in the public sector might well be useful. Despite the vagaries of the climate, the prospects for agricultural production seemed to be relatively favorable as the result of both the increasing use of modern techniques and the services offered by the Agricultural Bank. The financial program begun in 1979 had resulted in a decline in the overall deficit of the Central Government from the equivalent of 9 per cent of GDP in 1979 to approximately 5 per cent in 1980 and 1981; the authorities were to be commended for their intention of holding the deficit at the same level in 1982.

Certain new tax measures had already been implemented, Mr. de Maulde noted, and others were under consideration. A 19 per cent increase in revenues was expected in 1981, well in excess of the estimated 9 per cent rate of growth of expenditure. On the expenditure side, further progress in improving financial controls seemed to be called for. The recent creation of a National Public Investment Fund was an appropriate response to the previous rapid growth of extrabudgetary accounts. As for the public sector as a whole, there seemed to be a lack of information about the financial position of the state enterprises. Extended technical assistance in that area could be helpful, and he wondered whether it was under consideration in the Fund. What recommendations were contained in the study that had recently been completed by a commission to review the performance of the state enterprises? Although the rising cost of energy had constrained industrial development, the authorities had not succumbed to the temptation to subsidize petroleum prices, and the increases in the cost of imported energy had been fully reflected in domestic retail prices.

Monetary policy appeared to be adequate, Mr. de Maulde said. The rate of growth of money and quasi-money in 1981 and 1982 was expected to be less than the rate of increase in domestic prices.

In the external sector, Mr. de Maulde continued, no major problems had arisen in recent years. The overall balance of payments had been in surplus for some time, but the prospects for 1982 were somewhat less favorable because the level of private and official transfers was expected to fall. Some external borrowing might be required in the coming period, but the external debt situation was not a cause for concern; nevertheless, the mechanism for gathering data on it should be improved.

There was clearly a need to increase the rate of economic growth, Mr. de Maulde continued. The standard of living in Upper Volta was very low; per capita GDP was still only SDR 170. Increasing the rate of development would undoubtedly require a significant level of international support from bilateral and multilateral sources. The authorities of Upper Volta had indicated their interest in a possible medium-term arrangement with the Fund, and he looked forward to learning of the results of the mission that was scheduled to visit the country in early 1982. Given the nature of the problems facing Upper Volta, a joint mission with the World Bank might well be appropriate.

Mr. Jones commented that, while Upper Volta's economy had recorded a moderate rate of growth in recent years, there were clearly difficulties in several areas. The high level of consumption had consistently exceeded domestic production, and the gap had been growing; there had been a corresponding negative rate of growth in domestic savings. As a result, the country had been fully dependent on external sources to finance the development effort. The authorities seemed to be aware of the disruptive effect on project implementation of the lack of adequate domestic financing. Priority should be given to measures designed specifically to encourage domestic savings, and it would be useful to know the authorities' intentions in that area.

The weaknesses in the tax administration and in expenditure control were the main problems in the fiscal area, Mr. Jones considered. The revenue performance in 1981 had been less favorable than had been expected because of the difficulties in tax administration. In addition, extrabudgetary expenditure had become a major feature of government operations in recent years, and the steps that the authorities had taken to prevent unauthorized expenditures and overruns were certainly welcome. The new tax measures planned for 1982 were also welcome; the authorities intended to extend the corporate tax to the informal sector, and to raise certain excise taxes. As a result, budgetary expenditure in 1982 was expected to grow at a rate of no more than 10 per cent while revenues were expected to rise by 19 per cent. Given the tight budgetary situation, he agreed with the staff that the creation of a National Public Investment Fund would be a step in the right direction. Another problem in the area of public financing was the rising trend in recent years of subsidies for most of the larger public enterprises, which had experienced growing managerial difficulties. He hoped that the recently completed study on the enterprises made appropriate recommendations for improving the situation.

As for monetary policy, Mr. Jones said, the authorities had managed to continue to contain the growth of the monetary aggregates. The rate of growth in broad money in 1981 was expected to be 10 per cent, compared with the 15 per cent increase in nominal GDP. The rate of growth of credit had also been kept within the ceilings set by the authorities, although the share channeled to the priority sectors, such as rural development, industry, and infrastructure, had been declining.

Upper Volta's overall balance of payments had been in surplus or near equilibrium in the period 1979-81, Mr. Jones observed, but there had been large trade deficits, partly because of the deterioration in the terms of trade. The level of debt servicing was not a cause for concern, but he agreed with the staff that the authorities should be cautious to ensure that the proceeds of new external debt, including debt guaranteed by the Government, were used to enhance the country's productive and export capacity. Finally, the intention of the authorities to formulate a Fund-supported program for 1982 was welcome.

Mr. Erb considered that the problems facing Upper Volta were due in part to its landlocked position, limited resource base, and fairly large population. The country obviously had a need to increase development expenditures, and he wondered whether the staff felt that the authorities in Upper Volta had the administrative apparatus in general, and investment control mechanisms in particular, needed to keep the investment program and state enterprises from becoming a drain on the economy.

The staff representative from the African Department commented that, at present, the staff had no plans to provide technical assistance to improve the position of the state economic enterprises. The authorities themselves had been quite active in the field and had prepared a comprehensive report that was now under review at the highest political level. In addition, the World Bank had stationed a representative in Upper Volta. However, there was a Fund technical assistance mission in Upper Volta to help the authorities in the presentation of the budget, and in particular to make the budget comprehensive and to keep expenditures under control.

In the previous year, the staff representative explained, the authorities had provided no subsidies on petroleum prices. As for the excess in the rate of growth of consumption compared with the rate of growth of GDP, it had been due largely to the income provided by the sizable number of Upper Voltan nationals working in Ivory Coast. Hence, there had been no need in Upper Volta to cover development expenditures solely with foreign aid.

Commenting on the possibilities for increasing domestic savings, the staff representative said that the matter had been extensively discussed with the authorities. The conclusion had been that the brunt of the effort to increase savings would have to fall largely on the budget, because income in the private sector was still very low. The poor performance of the state economic enterprises had constituted a drain on savings, and the performance would have to be improved if savings were to increase.

The administrative apparatus for directing capital expenditures was fairly weak, the staff representative from the African Department continued, and the Fund and the World Bank staff had cooperated in an effort to improve it through the creation of a National Public Investment Fund, which would be partially staffed by technical assistants from the World Bank. The staff hoped that the composition of investment would be improved as a result of the work of the proposed Investment Fund. However, the trade unions in Upper Volta were relatively strong and had been pushing for the implementation of a railway project in the northern part of the country and for increases in salaries in the public sector. The staff's projections for 1982 should be approached with caution, because they assumed only small increases in salaries in 1982; given the pressure being exerted by the unions, the actual adjustments could be much larger.

Mr. Nana-Sinkam commented that approximately 480,000 Upper Voltans worked outside the country, most of them in Ivory Coast. They remitted some 60-70 per cent of their earnings to Upper Volta, thereby considerably enhancing the total income available to finance domestic consumption.

In the light of the very low level of per capita income in Upper Volta, Mr. Nana-Sinkam continued, it would be quite difficult to record an increase in savings from that source in the coming period. The authorities were taking all possible steps to increase savings through the budget. A staff mission was now in Upper Volta to assist the authorities in their effort to restructure the fiscal sector in preparation for the introduction of a Fund-supported medium-term stabilization program. He hoped that the mission could review the structure of expenditures and the various possibilities for controlling capital and current expenditures, particularly subsidies to the semipublic enterprises.

The Chairman made the following summing up:

The Executive Directors have indicated general agreement with the thrust of the views expressed in the staff appraisal. They noted that in recent years Upper Volta had experienced slow rates of growth and inadequate domestic savings. As the already large deficit on the external account is expected to widen and the overall balance of payments is projected to swing into deficit in 1981, Directors stressed that Upper Volta should take appropriate adjustment measures to reduce the imbalances facing the economy.

Directors expressed concern about the growing fiscal deficit and the lack of a consolidated framework for control and monitoring of investments and extrabudgetary outlays. They noted that in order to promote sustained growth, along with reduced internal and external imbalances, it was necessary to improve the financial performance of public enterprises, to avoid the proliferation of extrabudgetary accounts, to provide continued price incentives to the primary sector, to restrain wage increases, and to reduce the overall fiscal deficit.

Improvements were also needed in the management of overall treasury operations and of investment planning. Considerable caution was also needed with regard to the contracting of external debt.

Directors welcomed the authorities' emphasis on maintaining modest monetary expansion and their ongoing efforts to improve financial management of both the Treasury's operation and those of public enterprises. They felt that the deficits of parastatals should be reduced through management measures, realistic pricing policies, and appropriate restraints on wage increases.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with Upper Volta, in the light of the

1981 Article IV consultation with Upper Volta conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Upper Volta continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 7013-(81/158), adopted
December 16, 1981

3. PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with the People's Democratic Republic of Yemen (SM/81/214, 11/9/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in the People's Democratic Republic of Yemen (SM/81/232, 12/7/81).

Mr. Finaish made the following statement:

I would like to thank the staff for the two documents on the economy of the People's Democratic Republic of Yemen, SM/81/214 and SM/81/232.

The People's Democratic Republic of Yemen belongs to the group of developing countries whose per capita income is very low and whose economy is still in a relatively early phase of modernization. In its case, the economic setting is further characterized by a limited domestic resource base. However, in spite of these constraints, the country's economy has grown at fairly healthy rates in recent years. The growth of real GDP averaged about 8 per cent a year over the five-year period ended 1980. Significant progress has also been made in diversifying the productive base through a gradual structural transformation of the economy. These positive results have in large measure been made possible by the successful pursuit by the authorities in this centrally planned economy of policies aimed at mobilizing larger resources for development, both domestically and from abroad, and employing a large part of these resources for building basic infrastructure and expanding the commodity producing sectors. The investment program over the period absorbed on average about 35 per cent of GDP.

The emphasis on the diversification of the economy has been reflected in the process of growth taking place across a broad range of activities. Alongside the traditional service sectors, the real goods sectors, comprising agriculture, fisheries, industry, and construction, have recorded sizable growth. Substantial investments in infrastructure have strengthened the productive base. However, due to a combination of factors, the pace of growth slackened in 1980. Growth in the agricultural sector suffered from adverse weather conditions and, in some areas, from labor shortages. In the industrial sector, the major constraints on production were the shortage of skilled labor, power supply bottlenecks, and delays in the availability of needed inputs. The rate of growth in the economy is expected to recover to about 6 per cent in 1981 as a result of some easing of the supply bottlenecks.

The Second Five-Year Development Plan (1981-85) aims at a further strengthening and diversification of the productive base through a continuation of the policy of according priority to investment in infrastructure and the commodity producing sectors, while meeting the basic needs of the population. Within the commodity producing sectors--agriculture, fisheries, and industry--special emphasis will be placed on the alleviation of the supply constraints that have tended to impede growth in recent years. In particular, efforts are to be stepped up to ease the problem of the scarcity of skilled manpower. To this end, the measures being taken range from wage incentive schemes for greater productivity to a higher priority to vocational and technical education. To sustain and improve production incentives, the authorities have in recent years increasingly allowed price adjustments to reflect more adequately increases in the cost of production, and they intend to keep their pricing policies under careful review in the future. Reflecting the above set of policies, and the planned real investment over the Second Development Plan period of about twice the level over the preceding five years, the annual rate of growth of real GDP is projected to rise to about 10.5 per cent over the Plan period.

Financial developments in the economy in recent years have in the main been a reflection of the determined development efforts of the authorities in the face of a severely constrained domestic resource base. Although the revenues from taxes have shown considerable buoyancy in recent years--and this is evidenced by the increase in tax revenues by about 250 per cent and the doubling of the tax/GDP ratio to nearly 35 per cent over the five-year period ended 1980--the growth of revenues has not kept up with the increase in expenditure requirements. As a result, the overall budget deficit has hovered around 30 per cent of GDP in recent years. The bulk of the deficit has been financed by concessionary foreign assistance and the remainder, averaging about 10 per cent of GDP, by domestic bank financing. The authorities recognize that the fiscal situation calls for strengthening the efforts to increase revenues and for the continuation of a careful scrutiny of public expenditures and pricing policies.

The annual rate of growth of domestic liquidity has averaged about 27 per cent over the last three years. While a large part of the increase at this rate reflects the impact of external surpluses, it is partly due to the domestic bank financing of budget deficits. Liquidity growth during 1981 is, however, estimated to decelerate to about 11 per cent. This sharp deceleration is primarily on account of the contractionary impact of the emergence of a balance of payments deficit, which in the first half of the year almost completely offset the expansionary impact of the domestic bank financing of the fiscal deficit. Monetary expansion at the estimated rate in 1981 appears to be broadly consistent with the projected growth of real GDP and a moderation of inflationary pressures.

The overall balance of payments has consistently been in surplus since 1977. This position has been sustained primarily by sizable inflows of workers' remittances and foreign aid. The balance of payments position is, however, expected to show a moderate deficit in 1981. While receipts from these two items recorded another sizable increase, this was outstripped by the surge in imports associated with the stepping up of development activity with the initiation of the Second Plan. For the same reason, the deficit is expected to increase in 1982. To help reduce the drain on foreign exchange reserves, the authorities have arranged for some financial support from the Arab Monetary Fund for the current and coming years. Thereafter, with the continuing expansion of the productive base, merchandise exports can be expected to make a much larger contribution to foreign receipts in the future than hitherto, thereby strengthening the balance of payments position.

Mr. El-Khouri stated that he broadly agreed with the staff appraisal. The Government's economic policies in recent years had resulted in relatively high rates of economic growth, the diversification of the productive base of the economy, and the fairly successful mobilization of both domestic and external resources for development. Given the limited resource base of the economy, the development effort had been quite impressive.

As an incentive for producers, Mr. El-Khouri noted, the authorities had been moving domestic prices--especially in agriculture--in line with increases in costs since 1978. They should be encouraged to maintain that policy, especially in the light of the serious shortages of certain important consumption items, such as fruits and vegetables. Such items usually were not imported, and any increase in their production would enhance the well-being of the population.

The overall budget deficits in recent years had been fairly large, averaging the equivalent of approximately 30 per cent of GDP, Mr. El-Khouri commented. The portion of the overall deficits financed by the banking system had been equivalent to about 10 per cent of GDP. It was true that GDP might be underreported because of the social product concept used by the authorities, but the overall budget deficit was the equivalent of approximately 40 per cent of total expenditures and had clearly been exerting pressure on the money supply, which had been growing at the rapid rate of 30 per cent in recent years. The rate of increase of the money supply had decelerated somewhat in 1981, but that development had been due mainly to balance of payments factors rather than to domestic credit conditions. Hence, action was clearly needed to reduce the government deficit. Budget revenues were already large in relation to GDP, and the emphasis in the fiscal policy area would probably have to be on expenditure control. The estimated balance of payments deficits in 1981 and 1982, after a series of surpluses in the period 1977-80, showed the need for an intensification of the Government's stabilization effort.

Mr. Legarda considered that the economy had made satisfactory progress in recent years; the intensification of domestic and external resource mobilization had enabled the People's Democratic Republic of Yemen to record increases in both the level of investment and the rate of growth of real output. The increase in tax revenues had been impressive but had not kept pace with the rise in expenditures, and the overall budget deficit had remained large. The balance of payments was expected to record a deficit in 1981, and it was expected to grow in 1982 as a result of a 10 per cent rise in imports and a decline in exports caused by the relatively small fish catch and the reduction in aggregate output.

The staff had mentioned, Mr. Legarda noted, that labor shortages seemed to be hindering the implementation of certain projects. A large number of nationals apparently worked outside the country, and he wondered whether it would not be useful for the authorities either to review their emigration policy or to make their projects more capital intensive, thereby improving the balance between labor and capital within both the People's Democratic Republic of Yemen and the entire region.

In his opening statement Mr. Finaish had mentioned that the Yemeni authorities intended to seek assistance from the Arab Monetary Fund to help to reduce the drain on foreign exchange reserves, Mr. Legarda observed. The staff, however, seemed to have implied that a review of the exchange rate policy was called for in the effort to facilitate the rapid growth of remittances and exports and to safeguard the objectives of the development program. Did the authorities intend both to approach the Arab Monetary Fund and to make certain economic policy changes?

Mr. Erb commented that there seemed to be more exchange and trade controls and restrictions in the People's Democratic Republic of Yemen than in some of the other countries in the region. Did the authorities intend to reduce the restrictions on external flows?

Mr. Kharmawan remarked that the People's Democratic Republic of Yemen had central planning, and that the kind of controls on the economy which the staff had mentioned were typical of such a system. The Fund traditionally tended to feel that controls and restrictions were impediments to economic growth, but the People's Democratic Republic of Yemen had performed relatively well; indeed, the staff had concluded that the authorities had made satisfactory progress in both economic development and the balance of payments. What particular factors accounted for that success? Finally, the second sentence in paragraph 2 of the draft decision mentioned that some liberalization in the system of payments and transfers for current international transactions had been introduced since the previous consultation discussions. The language of the present text suggested that liberalization was always the best direction in which to move.

Mr. Caranicas commented that the good economic performance by the People's Democratic Republic of Yemen was explained in part by the assistance that it had received from neighboring countries and from the fairly high levels of workers' remittances. More important, the economy was closely controlled by the public sector, whose planning effort had been particularly efficient.

The staff representative from the Middle Eastern Department remarked that the authorities were keenly aware of the labor shortages that had been caused by emigration. However, emigration policy was something of a dilemma for the authorities, as emigration did provide certain benefits for the country. The Government had introduced some restrictions on the emigration of skilled laborers, but the border with the Yemen Arab Republic was quite open and movement across it was difficult to prevent. The authorities had been encouraging foreign contractors to bring their own labor with them for certain major projects, including some capital-intensive agricultural and industrial projects, and an effort was being made to reorient the educational system in the medium term toward vocational and technical education. The authorities' efforts had already been somewhat successful, but labor shortages had continued to occur in certain sectors, thereby adversely affecting output. The Government would undoubtedly have to continue to grapple with the labor shortage problem in the years to come.

Under its automatic loan facility, the Arab Monetary Fund had made SDR 23 million available to the People's Democratic Republic of Yemen in July 1981, the staff representative explained. Still, the staff believed that the authorities should keep the exchange system under review, particularly in the light of the important role played by workers' remittances and certain other external receipts in the financing of the Yemeni development effort. The authorities' policy should continue to encourage remittances by workers living abroad. In addition, nonresidents should be permitted to hold foreign exchange balances, and interest rates should be kept at attractive levels in order to encourage savings from abroad to be channeled into the Yemeni banking system. In the past such steps had helped to mobilize foreign resources, and the staff felt that they should be continued in the coming period.

The authorities' commitment to maintaining certain exchange controls was consistent with their preference for centralized planning, the staff representative remarked. They had taken some steps to simplify the system of external transactions, but they apparently did not intend to liberalize it completely.

One of the keys to the success of the performance of the economy in recent years was the authorities' consistently prudent financial policy stance, the staff representative from the Middle Eastern Department commented. Their expenditure targets had been reasonable, and they had relied extensively on concessional external development assistance. Their political organization had enabled them to mobilize the resources needed to support the public sector enterprises and the cooperative farms. The authorities had been able to decree a number of wage restraints and had taken a wage cut themselves on occasion in recent years while cutting the wages of workers in the public sector and on the cooperative farms.

Mr. Finaish said that the authorities had been following prudent financial policies in recent years. They had been closely monitoring the budget deficit and were aware that there was some room for further action on the expenditure side. Budget revenues were quite large in relation to GDP and reflected the authorities' impressive efforts in that regard.

It was worth recalling, Mr. Finaish added, that much of the deficit had been financed by concessional external assistance. The authorities were also aware of the need for following closely developments in the external sector. With the entering into effect of the new development plan for 1981-85, export production was expected to increase and to contribute thereby to the alleviation of pressures on the balance of payments.

Referring to the problem of labor shortages, Mr. Finaish remarked that there was considerable emigration of workers from the People's Democratic Republic of Yemen induced mainly by the relatively high wages offered in countries in the region, particularly in Saudi Arabia. The authorities had been placing due emphasis, in the reform of the educational system, on technical and vocational training while recognizing the need for appropriate incentives to keep the needed skilled labor. Finally, the People's Democratic Republic of Yemen's success in recent years had been due to a combination of factors, including the prudent financial policies, pragmatism in policy implementation, successful mobilization of domestic resources, and availability of external assistance.

The Chairman made the following summing up:

> The People's Democratic Republic of Yemen has over recent years made progress in its development and economic diversification efforts, although there was a marked slowdown in the growth of output in 1980. Directors noted the staff assessment that wider application of production incentives, together with measures to continue to deal with supply bottlenecks, is expected to lead to a recovery of growth.
>
> Directors commended the prudent financial policies followed in recent years. Government revenues have grown rapidly, and the growth of current expenditures has been kept under control.

Furthermore, important foreign assistance has added to the resources available for the financing of development. However, Directors expressed some concern about the size of the overall budget deficit and stressed the importance of limiting the growth of the bank-financed government deficit.

The balance of payments recorded considerable overall surpluses in the period 1977 to 1980, but is expected to record a small deficit in 1981, mainly as a result of the acceleration of the development effort and some increases in import prices.

The Executive Directors turned to the proposed decision.

Responding to a comment on the reference in paragraph 2 to the liberalization of the system for payments and transfers for current international transactions, the staff representative from the Middle Eastern Department remarked that there had been a general tendency to expand imports in order to satisfy consumer demand. Although all imports were controlled by the Government, the willingness of the authorities to expand the list of permissible imports could be seen as a deliberate step to increase the supply of imports. That measure might not be viewed by some as constituting a "liberalization" of the system, but the authorities had also clearly improved the arrangements under which expatriates could repatriate income earned in the People's Democratic Republic of Yemen; there had previously been restrictions on the repatriation of such earnings. Moreover, the authorities had made some minor adjustments in the repatriation of income from the sale of certain assets by foreigners in the People's Democratic Republic of Yemen, and there had been some liberalization of the arrangements for the opening of foreign exchange accounts. Taken together, the measures were clearly a move in the right direction, and the staff felt that they should be encouraged through the language of the proposed decision.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with the People's Democratic Republic of Yemen, in the light of the 1981 Article IV consultation with the People's Democratic Republic of Yemen conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The People's Democratic Republic of Yemen has continued to maintain comprehensive controls on payments and transfers for current international transactions in the context of a centrally planned economy. Some liberalization in the system was introduced since the last consultation discussions. The Fund notes that the authorities intend to continue reviewing the exchange control system with the objective of simplifying it further.

Decision No. 7014-(81/158), adopted
December 16, 1981

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/157 (12/14/81) and EBM/81/158 (12/16/81).

4. ARGENTINA - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/318 (12/10/81). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1981 Article IV consultation with Argentina until not later than December 21, 1981.

Decision No. 7015-(81/158), adopted
December 14, 1981

5. HAITI - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/320 (12/11/81). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1981 Article IV consultation with Haiti until not later than December 23, 1981.

Decision No. 7016-(81/158), adopted
December 15, 1981

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/95 through 81/97 are approved. (EBD/81/314, 12/9/81)

Adopted December 15, 1981

7. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/81/387 (12/14/81) is approved.

APPROVED: May 27, 1982

LEO VAN HOUTVEN
Secretary