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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/160

10:00 a.m., December 21, 1981

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

Executive Directors	Alternate Executive Directors
	O. Kabbaj
	C. Taylor
A. Buira	
	J. E. Leimone, Temporary
	L. E. J. Coene, Temporary
	A. Le Lorier
	T. Alhaimus
T. Hirao	A. Nagashima
J. C. Iarezza	R. T. Salazar
R. K. Joyce	M. Casey
	J. R. Novaes de Almeida, Temporary
B. Kharmawan	
S. Kiingi	
G. Laske	G. Winkelmann
	C. P. Caranicas
S. Nana-Sinkam	A. Alfidja
	A. S. Jayawardena
	S. El-Khouri
J. J. Polak	J. Schuijer, Temporary
A. R. G. Prowse	B. Legarda
J. Sigurdsson	L. Vidvei
	Tai Q.

A. Wright, Acting Secretary
K. S. Friedman, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; R. J. Bhatia, Deputy Director; N. Abu-zobaa, E. L. Bornemann, J. P. Briffaux, I. A. H. Diogo, C. Enweze, M. G. Gilman, B. Karlstroem, J. M. Kratz, S. M. Nsouli, B. R. H. S. Rajcoomar. Asian Department: T. T. Gibson. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; W. S. Tseng. External Relations Department: G. P. Newman. Legal Department: J. V. Surr. Treasurer's Department: A. M. Al-Samarrie. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. Bouchard, A. B. Diao, K. V. Jännäri, G. Jauregui, S.-W. Kwon, F. Yeo T. Y. Assistants to Executive Directors: L. Barbone, R. J. J. Costa, M. K. Diallo, F. Guena, Jiang H., M. Michelangeli, V. K. S. Nair, Y. Okubo, J. G. Pedersen, C. N. Pinfield, D. V. Pritchett, J. Reddy, D. I. S. Shaw, H. Suzuki, O. Üçer, A. Yasseri, A. a. Yousef.

1. MAURITIUS - STAND-BY ARRANGEMENT AND EXCHANGE SYSTEM

The Executive Directors considered requests by Mauritius for a stand-by arrangement equivalent to SDR 30 million and approval of a mutiple currency practice (EBS/81/236, 12/7/81; and Cor. 1, 12/18/81).

Mr. Nana-Sinkam made the following statement:

> My authorities fully appreciate the thoughtful and valuable assistance that they have received from the Fund management and staff, especially during the previous two years, when the country was hit by a series of devastating cyclones. My authorities remain committed to maintaining close collaboration with the Fund.
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> The past few years have been extremely difficult for Mauritius; budget deficits have persisted, and the external financial position has continued to worsen. This difficult economic and financial situation is clearly analyzed in the staff report and was discussed by the Executive Directors as recently as April 1981. The difficulties stem largely from the expansionary policies that Mauritius, and many other primary commodity producers, adopted in the wake of the commodity boom of the mid-1970s. My Mauritian authorities have been given full credit for being alert, for recognizing the gravity of the situation, and for initiating in a timely fashion the required adjustment program. However, they have been hindered in their sincere and determined adjustment efforts by the adverse impact of the series of four cyclones and the related flooding that ravaged the country in December 1979, March 1980, and in 1981. Despite the hardships, the authorities have persevered in their efforts to promote adjustment and they welcomed the Fund's approval of the stand-by arrangement that ended in September 1981. Their performance under the stand-by arrangement was satisfactory; all the policy measures were implemented, and all the performance criteria were fully met.
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> The proposed stand-by arrangement is designed to allow the Mauritian authorities to sustain their commendable efforts to achieve the required adjustment through a mediumterm stabilization program. The financial program for which Fund support is sought was elaborated with the full collaboration of both the Fund management and staff. Indeed, during the past few months there have been several contacts between the Fund and the Mauritian authorities, including a visit by the Prime Minister to the Managing Director. The program is sound and courageous; it aims at limiting the overall balance of payments deficit to SDR 65 million. The policies needed to attain this objective are summarized in Table 8 of EBS/81/236.

In the fiscal field, the authorities agree with the staff that the budget deficits of the recent past cannot be sustained in the coming period. Accordingly, the authorities are determined to introduce strong fiscal measures to reduce the overall deficit from the equivalent of 14.9 per cent of GDP to 12.9 per cent. They intend to increase government revenues by 23 per cent through discretionary measures, and they have modified the exchange rate of the rupee. The authorities also agree with the staff that tax administration and collection need to be improved; the tax system should be simplified and made more efficient. On the expenditure side, government outlays are to be cut by 6 per cent in real terms, and major action should be taken in the area of subsidies. The authorities are committed to tightening expenditure control and have introduced monthly guidelines for all government expenditures.

The authorities' wage and pricing policies continue to be firm while, of course, duly reflecting the political realities in the country. As the staff noted on page 19, the wage increases granted in June 1981--15.5 per cent in the private sector and 13 per cent in the public sector--only partially compensated for the 28 per cent increase in the cost of living. No additional increases are scheduled for the rest of the fiscal year, and wage policy for 1982/83 will be developed in close consultation with the Fund. As for pricing policy, a pass-through policy has been initiated, but the authorities recognize that great care is needed to take into account fully the social realities of the country.

In the monetary field, the objective continues to be to contain domestic demand while ensuring that productive activities are fully financed. Total domestic credit expansion is to be limited to a rate of about 21 per cent, and net credit to the Government will be limited to Rs 690 million in fiscal year 1981/82. As for interest rates, the authorities have adopted a policy that reflects market forces more fully than previous policy. Indeed, the reactivation of the interbank market has led to a sharp increase in the interbank rate, from 9 per cent to 13.5 per cent. Moreover, the authorities have abolished all ceilings on lending and deposit rates, thereby promoting both competition among the various banks and greater overall efficiency of the banking system.

Externally, the objective of the program is to limit the overall balance of payments deficit to SDR 65 million. The authorities already made a 16.7 per cent adjustment in the exchange rate in September in response to the movement of currencies of major trading partners and, more important, with a view to making Mauritian exports, particularly sugar, more competitive, thereby restoring dynamism to the export sector as a means, inter alia, of alleviating the pressing unemployment problem. In the light of experience, it is reasonable to expect substantial gains from the exchange rate action, especially in the export processing zone.

The multiple currency practice in effect is a temporary measure required by the prevailing circumstances. It will be reviewed before May 31, 1982, in other words, prior to the scheduled drawings at that stage of the stand-by arrangement. In sum, the authorities' program is sound, and I strongly commend it to the Executive Board.

Mr. Joyce remarked that, if approved, the proposed stand-by arrangement would constitute the fourth use by Mauritius of Fund resources; in the past, the Government had made drawings under the compensatory financing facility and had implemented a stand-by arrangement. He agreed with the staff appraisal and could accept the proposed decisions. One of the reasons for his full acceptance of the requests was the authorities' remarkably satisfactory performance under the previous stand-by arrangement. The trigger mechanism, under which the authorities were to have contacted the Managing Director if they had encountered difficulties in implementing the stand-by arrangement, had never been used. Mauritius' experience, however, showed how difficult it was to bring a small island economy back on track, particularly if it was dependent on agriculture and fishing and, hence, on weather conditions. While it was true that Mauritius' problems had originally been caused by the authorities' policy decisions, and particularly the excessive expenditure during the sugar export boom, the recent worsening of conditions had been caused by factors beyond the control of the authorities.

Since 1979, Mr. Joyce continued, the authorities had adopted a number of courageous measures designed to bring the economic situation under control. The first major step had been the depreciation of the exchange rate. More recently, the authorities had raised retail sugar prices, allowed the domestic price of oil to rise to international levels, and maintained a wage policy that had given wage earners only partial compensation for inflation; they planned to maintain an equally cautious approach to increases in nominal wages in 1982/83. The Executive Directors would of course wish to examine wage developments again on the occasion of the mid-term review of the proposed financial program. The authorities had also introduced a wide range of taxes and import duties in recent years; in the present fiscal year alone they had increased the surcharge on indirect taxes, had further expanded the coverage of stamp duties, and had imposed a new import duty on aviation fuel. Such measures were not easy to implement, particularly over a long period, but Mauritius had had no alternative; the problems that it had originally faced had been intensified by the serious adverse effects of the cyclones that had struck in 1980 and 1981--when a major portion of the sugar crop had been destroyed and the fishing fleet damaged--and by a significant drought and a decline in the terms of trade. In the circumstances, he fully sympathized with the authorities. They were to be commended for the steps already taken and for their intentions to maintain appropriate policies during the coming year.

The balance of payments situation was still quite difficult, Mr. Joyce noted. There had been some increase in European sugar prices, but the level of production in Mauritius was still fairly low, and no major positive developments were expected soon. Still, total exports, particularly those originating in the export processing zone, had expanded at a remarkable rate since 1979; tourism had also performed well, even though there were some signs that the competitive edge that Mauritius had regained as a result of the depreciation in 1979 had been partly lost in recent months. If that trend continued, the rate of expansion of exports and tourism would probably slow. In addition, during the present year the volume of imports was expected to continue its downward trend.

In the circumstances, the staff had forecast that the ratio of the balance of payments deficit to GDP would fall by approximately two percentage points, although the deficit would still be substantial, about SDR 65 million, and Mauritius would continue to have to rely on medium-term capital inflows, Mr. Joyce remarked. However, on page 25 the staff had noted that, while external factors had contributed to the budget deficit, domestic and adjustment measures "will have to offset their impact if the balance of payments deficits are to be reduced to viable proportions within a two-to-three-year period and before Mauritius has exhausted its capacity to attract external balance of payments support." Did the staff mean that, if Mauritius did not solve its budgetary problems within the year of the new financial program, it would probably be unable to attract sufficient flows of medium-term capital to cover the external deficit?

The authorities seemed to agree with the staff, Mr. Joyce continued, that the budget deficit was unsustainably high and should be reduced even further, however difficult the task might be. The large subsidies on rice and flour had clearly contributed to the budgetary problems. The authorities intended to reduce the subsidies, but, for social reasons, the rate of decline would have to be gradual. To what extent would the removal of the multiple currency practice have a positive effect on the government deficit? Apparently the subsidies on rice and flour were in practice extended through the multiple currency practice itself.

The staff seemed to feel, Mr. Joyce commented, that the revenue system was inelastic and, indeed, that there was a declining effective tax rate on imports. The staff had suggested that the inelasticity might have been due to weak administration and to the large number of permissible tax exemptions. What steps did the autorities plan to take to strengthen tax administration? What improvements in the tax system was the fiscal expert now in Mauritius trying to promote? The practical limits on taxation appeared to be on the verge of being reached, and apparently the only options available to the authorities were to improve tax collection and administration and to reduce expenditures, including, perhaps, subsidies. The staff had indicated the need both for a thorough examination of capital expenditures and for a rationalization of the state enterprises, and he wondered what measures the authorities intended to introduce in those areas.

Commenting on monetary policy, Mr. Joyce said that the authorities were to be commended for the steps that they had recently taken. The freeing of interest rates and the reactivation of the interbank system should make a considerable contribution to the effort both to control overall credit expansion and to ensure a more efficient allocation of resources.

The quantitative performance criteria were to include a ceiling on new external borrowing commitments and a subceiling on the drawdown of new external borrowing, Mr. Joyce noted. The subceiling was particularly interesting, and he wondered whether it had been used in any previous stand-by arrangements for other countries. The authorities had decided to establish monthly guidelines on total expenditures and to monitor project financing, and it would be useful to receive a comment on precisely how those steps were to be taken.

The authorities planned to implement their new policies in the present fiscal year, which corresponded to the first half of the proposed stand-by arrangement, Mr. Joyce noted. The mid-term review scheduled for the spring of 1982 would therefore be particularly important; it would show the progress that the authorities had been able to make and the additional policies that might be needed. Finally, he wondered whether the new stand-by arrangement, like the old one, would have a trigger mechanism under which the authorities would consult the Managing Director if they encountered difficulties in implementing the financial program.

Mr. Leimone stated that the proposed decisions were acceptable. Mauritius' considerable adjustment effort under the recently expired stand-by arrangement had been frustrated to a considerable extent by the severe and persistent decline in the terms of trade and by the adverse effects of weather conditions on the production of sugar, the main export crop. In response to the continued deterioration in the balance of payments position, the authorities had committed themselves to implementing further adjustment measures under the proposed program.

The new measures were generally welcome, Mr. Leimone commented, but there was still some cause for concern about the economy. For instance, the projections for the balance of payments included a potential financing gap of about SDR 35 million. What were the prospects for obtaining the needed financing? If the additional financing was arranged, it would of course add to the already sizable debt service burden.

Further adjustment was needed to counter the large external current account deficit projected for the medium term, Mr. Leimone considered. One area where further adjustment might be necessary was the exchange rate. The cumulative depreciation since 1979 had been considerably less than the rate of domestic inflation; further evidence that the international competitive position of Mauritius had weakened in the previous two years was the rapid rise in unit labor costs for sugar production.

Despite the adjustments that had been made in the past two years, Mr. Leimone commented, the fiscal deficit was still projected to be quite large, equivalent to nearly 13 per cent of GDP in 1981/82. It would be extremely difficult for the authorities to attain a sustainable balance of payments position until they were able to reduce the fiscal deficit. Further reductions in subsidies--which continued to account for approximately 2 per cent of GDP--should be carefully considered as part of the overall effort to trim the budget. Constraining domestic demand would contribute directly to the effort to improve the external trade balance. He noted that the authorities had assured the staff that they intended to intensify further their adjustment effort in the coming fiscal year, and he looked forward to the mid-term review in the spring of 1982.

Mr. Taylor said that he too felt that the Mauritian authorities were to be congratulated on their effective implementation of adjustment measures under the recently expired stand-by arrangement. The authorities had had to struggle with a variety of adverse conditions, and congratulations were particularly in order for the realistic and flexible interest rate and exchange rate policies. The substantial adjustment of real wages in 1979-80 and 1980-81, although painful in the short run, should be constructive in the longer term.

Given the authorities' good record in recent years, Mr. Taylor continued, he was pleased to accept the proposed decisions. However, the authorities should be urged to maintain their prudent economic management, in part because recent experience had shown that the economy was quite vulnerable to external shocks and the authorities had little margin for error. The new program seemed to be realistic and, although the volume of resources involved was relatively moderate, the performance criteria were comprehensive. In passing, he found the summary of the financial program provided in Table 8 particularly useful.

The fiscal prospects were rather bleak, Mr. Taylor commented. There was obviously still a need for the authorities to concentrate their efforts on containing the budget deficit and, in that connection, the recently adopted revenue measures and expenditure monitoring techniques should be helpful.

He agreed with previous speakers who had mentioned that a reduction in subsidies would contribute to the effort to control the budget deficit, Mr. Taylor remarked. There were understandable social reasons for maintaining the subsidies, particularly in the light of the high rate of inflation, but they clearly constituted a substantial drain on the budget. A reconsideration of the policy on subsidies might be a useful part of the spring 1982 mid-term review.

The authorities would have to maintain their restrictive wage policy if the budgetary targets were to be achieved, Mr. Taylor said. The tough policy in the public sector would set the standard for wage adjustments in other sectors, thereby helping to maintain the country's competitive position. There had been substantial declines in real wages in the previous two years, and he wondered whether the restrictive wage policy could be maintained much longer.

There had been a sizable decline in the contribution of personal income taxes to total revenues, Mr. Taylor observed. Given the large size of the budget deficit and the heavy strain that it was placing on the implementation of an effective monetary policy, he wondered whether an effort should not be made to increase the contribution from that source. The staff had projected a reduction in the proportion of the budget deficit that would be financed by the domestic banking system, but the deficit was clearly undermining the authorities' counterinflation effort.

The proposed curb in the growth of domestic credit seemed necessary, Mr. Taylor said, but it would probably create distortions and lessen the efficiency of resource allocation. Hence, the recent decontrol of interest rates and the associated increases were welcome. Still, real interest rates seemed to be quite negative, and he wondered whether the authorities did not feel that further increases were desirable, and whether they planned to abolish the remaining ceilings on certain lending rates.

An exchange rate adjustment had clearly been needed, Mr. Taylor remarked, but the limited scope of the recent adjustment had been disappointing; it had resulted in the creation of a dual exchange rate system. The authorities' assurance that the system was temporary was welcome. He hoped that the authorities would take the occasion of the spring 1982 mid-term review to consider unifying the exchange rates. The devaluation should help to improve the price competitiveness of exports, but, given the recession in the world economy and the increase in protectionism in a number of Mauritius' traditional export markets, he wondered whether the projected increase in the volume of exports in 1981-82 was realistic. The authorities' effort to seek new export markets would be important, especially as failure to achieve the targeted level of exports could make it difficult for the authorities to reach the projected rate of real growth of 5 per cent; in that event, the stabilization effort might well be undermined. Finally, apparently the authorities had long intended to enter into an extended arrangement with the Fund, and he wondered whether they still planned to do so.

Mr. Prowse remarked that he too had found Table 8 to be particularly useful. The draft decisions were fully acceptable. The proposed stand-by arrangement was in effect a continuation of the successful stand-by arrangement that had recently expired. The small island economy of Mauritius had recorded impressive achievements despite the substantial damage done to the sugar crop by a series of cyclones. The authorities had made full use of the policy measures that were available to them, including a reduction in the level of subsidies. However, the cost of the subsidies should not be overstated; in theory and in practice the Executive Board should encourage the authorities to reduce the subsidies even further, but their continued existence should not give rise to major criticism.

The proposed program, Mr. Prowse went on, should move the economy much closer to a path of sustainable growth, but there was still a good deal to be done, especially to reduce the budget deficit. However, as the staff had concluded, the authorities had already made an exceptional effort on the revenue side; and the staff had wisely suggested that, in the coming period, attention would have to be focused on the expenditure side.

On page 19, Mr. Prowse noted, the staff had mentioned that, given the protectionist environment in the traditional markets for Mauritius' exports, the Government should attempt to diversify the country's export markets. Protectionist measures both in large economic groups and in individual countries severely affected a small island economy like that of Mauritius. The need for a Fund-supported stabilization program in Mauritius had been intensified by the restrictions imposed in Mauritius' export markets.

Mr. Schuijer commented that, although Mauritius had suffered from a series of cyclones and a drought, the authorities' performance under the recent stand-by arrangement had been satisfactory. At first glance, it seemed better to encourage Mauritius to use the compensatory financing facility than to request another stand-by arrangement, especially as the main problem facing the economy seemed to be the decline in earnings from sugar exports, but Mauritius had already drawn all the resources available to it under the facility to cover the export shortfall in 1980. The actual volume of sugar exports in 1981 had been lower than expected, and he wondered whether any new estimates of the shortfall had been made.

The economic program for the coming year would probably move the economy in the right direction, Mr. Schuijer said, but the external current account deficit and the public sector deficit both remained unsustainably large. Mauritius wished to improve its external competitiveness, but it had no influence on the price of its main export product; therefore, its external adjustment efforts would have to center on the exchange rate mechanism. The recent devaluation of the rupee had been aimed merely at countering the effective appreciation resulting from the pegging of the rupee to the SDR, and he wondered whether the staff felt that, given the need to improve the external competitive position, the exchange rate adjustment had been sufficient.

The authorities understandably wished to avoid lowering the standard of living by further reducing subsidies and, for that reason, the proposed temporary multiple currency practice was acceptable, Mr. Schuijer remarked. Still, the public sector deficit was excessively large, and a further reduction in the level of subsidies in the near future would be unavoidable. On the revenue side, the staff had concluded that the structure of tax revenues was inelastic, and it had made several recommendations designed to enhance tax collections. He wondered whether the authorities had in mind any concrete measures to improve tax revenues.

There were some uncertainties about the new program, Mr. Schuijer concluded, but the authorities seemed to be doing everything that could be reasonably expected of them. He accepted the proposed decision and looked forward to learning more about the economy at the mid-term review in the spring of 1982.

The Deputy Director of the African Department remarked that, even with the approval of the proposed stand-by arrangement, Mauritius would need approximately SDR 30-35 million to close the balance of payments financing gap. The authorities had already contacted certain banks, and the needed financing would probably be available. The performance criteria for member countries usually did not include a subceiling on the drawdown of external loans, but the staff felt that Mauritius might have to use the Eurodollar market in the coming year, and that the authorities could appropriately borrow enough to cover the financing need for both 1981 and 1982; given the present late stage of fiscal year 1981, the staff had concluded that it would be useful for the authorities to borrow enough to meet the balance of payments financing needs both in the present year and in the coming one.

The subsidy policy, the Deputy Director continued, had originally been introduced during the sugar boom and had not been designed primarily to counter the effects of the high rate of inflation; it had been meant to redistribute income and to provide additional income to the lower-income groups. Since then, the focus of subsidy policy had changed. In late 1979 the authorities had taken a decision in principle that the subsidies should be gradually reduced and, in fact, the prices on the relevant items had subsequently been raised. As a result, the ratio of subsidies to total costs had fallen from approximately 63 per cent in 1979 to about 49 per cent in 1980. The appreciation of the U.S. dollar since the beginning of 1981 had raised import costs in local prices, and, in those circumstances, the authorities felt that it would be inappropriate to seek a further reduction in subsidies in the current fiscal year. Hence, the ratio of subsidies to overall costs had recently returned to about the level that had prevailed in early 1979. However, the Government had not changed its basic policy of seeking to reduce the subsidies gradually, and the staff expected that a fairly substantial reduction would be made in connection with the new budget.

Once the authorities realized that the budget receipts from various taxes were lower than had been expected, they had introduced a number of measures to improve tax administration, the Deputy Director explained. For instance, the Minister of Finance had decided to hold monthly meetings with the various tax commissioners in an effort to encourage them to increase collections. In addition, various penalties for tax payment delinquency had been introduced and had already begun to have a positive effect on the reduction of tax arrears. On the expenditure side, expenditures were monitored on a monthly basis; indeed, there were informal monthly ceilings on expenditures as a part of the effort to monitor the budget ceilings under the new program. Moreover, following the recommendations by the Fund technical assistance mission, the authorities had introduced a unified revenue service, which should help to improve tax collections. The authorities had received considerable technical assistance in tax reform, and they intended to introduce in the near future--probably in connection with the new budget--a sales tax that would give the revenue system the needed elasticity.

The removal of the multiple currency practice would have no effect on the budget, the Deputy Director explained. The estimated exchange loss in 1981-82 of Rs 35 million was being covered by the Central Bank, but the remaining subsidies--equivalent to Rs 235 million--were covered by the budget. The expectation was that, once the multiple currency practice was eliminated, there would be a corresponding increase in subsidies, so that there would be no net positive effect on the budget. At present, subsidies covered approximately half of actual costs; to reduce that proportion, prices of the relevant items would have to be increased by more than the 15 per cent rise in the rupee cost of imported commodities resulting from the recent devaluation of the rupee.

The authorities had decided to permit market forces to fix interest rates, the Deputy Director commented, and borrowing rates in the interbank market had risen to 13 per cent, compared with the rate of inflation of approximately 20 per cent. The staff hoped that interest rates would be maintained at a realistic level without choking off needed additional investment. Interest rates in Mauritius should be assessed in terms of the desirable return on capital rather than of the cost of living index.

The staff felt, the Deputy Director said, that the authorities had gone about as far as they could in maintaining a policy of a gradual reduction in real wages. The accumulated decline in real wages since the implementation of the policy had been approximately 30-35 per cent; in real terms, wages at the end of fiscal year 1981 would be approximately the same as in 1974, before the introduction of the expansionary policies. Presumably the authorities would attempt to preserve the level of real wages in the coming period by granting some increases in keeping with the real rise in GDP, while of course taking into account the appropriate distribution between the higher-income and lower-income groups.

The recent increases in wages could have reduced the competitiveness of Mauritius' exports, particularly sugar, the Deputy Director remarked, but the depreciation of the currency had helped to maintain competitiveness. If excessive wage increases and further changes in international exchange rates did not occur, the present exchange rate would probably continue to be viable in the coming two or three years.

The question had been raised, the Deputy Director recalled, why the proposed stand-by arrangement did not contain the same number of subceilings as the one that had expired, or a trigger mechanism for consultation with the staff. When the previous stand-by arrangement had been negotiated, there had been some uncertainty about the size of the sugar crop; there had been no such uncertainty during the negotiations for the proposed stand-by arrangement. Moreover, cooperation between the staff and the authorities had been growing; there had been considerable informal consultation, obviating the need for a formal mechanism of consultation. Indeed, the authorities had requested another staff mission early in 1982 essentially to review the interest rate and exchange rate policies.

The staff had estimated, the Deputy Director remarked, that the balance of payments position should become viable in the coming two or three years. If the present adjustment policies were maintained, the overall budget deficit as a proportion of GDP should fall to about 8 per cent by 1983. The overall balance of payments deficit, at present approximately SDR 65 million, should decline to approximately SDR 25 million in the coming two years. The cumulative external deficit during the coming two years should amount to no more than SDR 60 million, which would be less than Mauritius' remaining potential drawing rights on the Fund. The debt service ratio was high and was expected to rise to about 20 per cent in 1983-84, but it would probably fall to about 16 per cent in 1984-85.

The staff had originally anticipated that an extended arrangement for Mauritius could already have been negotiated, the Deputy Director of the African Department concluded. On that expectation, the World Bank staff--which had cooperated closely with the Fund staff--had already negotiated a structural adjustment loan with the authorities. It seemed best to wait until the present uncertainties about likely future developments were cleared up before undertaking negotiations for an extended arrangement.

Mr. Nana-Sinkam commented that the case of Mauritius raised again the issue of the appropriate pace of adjustment in a very small member country. It was difficult for a country that relied on a single export crop to make adjustments in a short period. Given the destructiveness of the series of cyclones that had struck the country, it would have been unreasonable for the Fund to expect Mauritius to eliminate the imbalances in the economy under the previous stand-by arrangement. The new financial program constituted a realistic but serious attempt at further adjustment. The authorities had performed well under the previous stand-by arrangement, but in assessing the prospects for the coming period Executive Directors should bear in mind that the present government held only a slim majority in parliament and was therefore somewhat constrained in its ability to introduce appropriate policies. Given the pressures facing them, the authorities had shown great courage in maintaining wage restraint; after the devaluation of the rupee, they had resisted the pressures to increase salaries to the full extent that wage earners had requested. In the circumstances, however, it would be difficult for the authorities to increase the contribution of personal income taxes to total revenues.

Commenting on the performance criteria under the new stand-by arrangement, Mr. Nana-Sinkam said that, given the likely developments in 1982, the staff had thought that it would be wise to ask the authorities to limit the drawdown of external medium-term borrowing commitments in order to be certain that sufficient resources would be available for fiscal year 1982/83, which would begin in June 1982. As for a trigger mechanism on consultation with the Fund, it seemed unnecessary to include one in the new stand-by arrangement.

It was true, Mr. Nana-Sinkam continued, that the balance of payments financing gap remained large, even after the adjustments already made, and that the staff's projection of the deficit in the coming period depended significantly on the approval of an important bank loan. However, a country like Mauritius, which depended upon a single export crop, and whose terms of trade had deteriorated in the recent past, could not hope to correct its external imbalance within a period as short as one year. Similarly, while an exchange rate adjustment was required, it would have to be gradual, particularly as it had to be complemented by continued restraint on wages in Mauritius; a major exchange rate adjustment in a brief period would not be feasible. Similarly, the budget deficit would continue to be fairly large under the proposed program, as the country could not be expected to make a major adjustment in that area in a single year; the authorities wished to cooperate with the Fund, and requiring an even more sizable adjustment of the budget deficit would merely invite failure.

The authorities clearly felt that the multiple currency practice was temporary, Mr. Nana-Sinkam said. They hoped that it could be removed by the time of the mid-term review in the spring of 1982. They also hoped that they would be in a position to begin negotiations on an extended arrangement after the next round of elections.

It was difficult for the authorities to adjust interest rates in Mauritius to the rapid fluctuations in interest rates abroad, Mr. Nana-Sinkam remarked. However, the authorities had moved in that direction with their decision freeing the interbank rate.

It was true, Mr. Nana-Sinkam said, that the conditions in Mauritius were appropriate for compensatory financing, but Mauritius had already exhausted its access to the compensatory financing facility. In any event, given the country's great reliance on its major export crop, any reduction in revenues from that crop had a significant and lasting effect on the whole economy.

At the present early stage, Mr. Nana-Sinkam remarked, it was difficult to know for certain whether the devaluation of the rupee had been sufficient. The level of the adjustment seemed to be appropriate in the light of the particular objectives that the authorities had established.

The Chairman noted that the staff would certainly benefit from Executive Directors' comments in its further discussions with the authorities. Staff and management clearly understood the need for further adjustment in Mauritius. The budget deficit was still rather high, and, although a considerable effort had been made on the revenue side, additional measures would have to be introduced. A further effort would also have to be made on the expenditure side. The subsidies had weighed heavily on the budget, and staff and management had been pressing the authorities to reduce the subsidies in order to obtain a sustainable budget position.

Subsidies and exchange rates were of course sensitive matters, the Chairman continued, and the Fund had to approach them in a cautious way. The authorities in Mauritius had performed well under the previous stand-by arrangement, and the Fund had to pay close attention to their views on the question of the timing of the phasing out of the subsidies. Still, the subsidies were one of the major problems that the authorities would have to tackle in the coming period. The Fund would have to keep a close watch on all of the factors mentioned at the present meeting--including the budget, subsidies, and the competitive position of Mauritius--in the effort to help the country to achieve a viable balance of payments position.

Mauritius would also need continued official development assistance, the Chairman said. The country merited such assistance, and the Fund, together with the World Bank, had played an active role, in coordinating the effort to encourage international cooperation on its behalf. The Government itself would of course have to make a major adjustment effort, but its task would be greatly facilitated by the provision of continuous effective assistance by the Fund, the World Bank, regional development organizations, and governments.

The Executive Board then turned to the proposed decision, which it approved.

The decision was:

Stand-By Arrangement and Exchange System

1. The Government of Mauritius has requested a stand-by arrangement for the period from December 21, 1981 to December 20, 1982 for an amount equivalent to SDR 30 million.

2. The Fund approves the stand-by arrangement attached to EBS/81/236 (12/7/81) and waives the limitations in Article V, Section 3(b)(iii).

3. The Fund grants approval for the retention of the multiple currency practice described in EBS/81/236 until May 31, 1982.

Decision No. 7020-(81/160), adopted
December 21, 1981

2. NIGER - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Niger (SM/81/204, 10/28/81). They also had before them a report on recent economic developments in Niger (SM/81/217, 11/17/81).

Mr. Alfidja made the following statement:

The major tasks of economic management facing the Nigerien authorities continute to be to maintain a high rate of growth with relative price stability, reduce dependence on external food assistance and imports, achieve a better income distribution, broaden the productive base of the economy, reduce the burden of external debt on the country's usable resources, and maintain a liberal system of trade and payments.

There is no doubt that, up to now, the authorities have remarkably succeeded in this effort. Despite the falling world market prices for uranium, the major single export product of Niger, the growth rate of GDP is still estimated to be 12 per cent in 1979 and 5.0 per cent in 1980, compared with the 9.5 per cent which was the Plan target for the two years.

The development that brought about these fluctuations is well analyzed in the excellent reports prepared by the staff, to whom I wish to express my authorities' deep appreciation and mine.

When the 1979-83 Development Plan was set up, it was considered ambitious. In retrospect, it can be said that the Plan was well designed and that the objectives were reasonable. In addition, the authorities had indicated that they intended to follow a pragmatic approach and were prepared to introduce during the annual reviews any adjustment required by changes of internal and/or external circumstances beyond their control. In fact, since the expected external revenues failed to materialize at the level forecast and because of other unforeseen circumstances, the authorities have decided to delay the implementation of some important projects such as the sugar complex.

Two of the objectives of the Development Plan are to diversify the productive base of the economy and to expand the capacity of the mining sector. In that context, the third uranium mine is under construction and production by it should start within two years or so. New export prices for Niger's mineral products will be announced sometime in January or February and are expected to be 40 to 50 per cent higher than those forecast by the World Bank. This welcome result of negotiations between the Nigerien authorities and their foreign partners will enhance the budget revenues and will help reduce the country's reliance on foreign investment for ongoing development.

In order to increase the financial incentives for agricultural production, producer prices, which had remained unchanged since 1978/79, have been increased and subsidies have been reduced, particularly for food crops. The reduction in subsidies will alleviate the burden on the expenditure side of the government budget. In addition to the development of rain-fed crops and the different measures to increase productivity, the expected increase in food crop output will enhance domestic supply and reduce the level of imports of millet, sorghum, and rice.

In the fiscal field, the Government has followed in recent years a deliberate income redistribution policy aimed at reducing the tax burden on less privileged segments of the society. One of the different measures to overhaul the tax system was to exempt people earning CFAF 200,000 or less from tax on salaries and wages and to levy a 30 per cent income tax on those earning more than CFAF 200,000, including nonresidents. This This structure of taxation, while leading to an appropriate income distribution, will not have any detrimental impact on government revenues.

On the external debt situation, it should be noted that one of the major reasons for the escalation of the debt service ratio is the world market fluctuations of the exchange rates of the currencies involved in the country's debt. It should also be underlined that debts contracted by the Nigerien authorities are linked to productive projects, particularly in the mining sector.

There is no doubt that the appropriate implementation of the financial program for the period April 1980-March 1981 has helped to keep the overall external deficit at a manageable level despite the detrimental impact of the world price for uranium, which represents some of the 80 per cent of the export receipts of the country.

Miss Le Lorier remarked that, despite the rapid economic growth in Niger in the past few years, the prospects for the economy in the coming period were far from satisfactory, mainly because of the declining price of uranium. The staff had forecast a slowdown in economic growth, a widening of the deficits for budgetary and extrabudgetary operations, and an increase in both the balance of payments deficit and the external debt burden.

On the supply side, Miss Le Lorier continued, the uranium sector clearly continued to play a critical role in the economy, accounting for one sixth of nominal GDP and about 80 per cent of total exports. Unfortunately, the price of uranium was not likely to be as favorable in the future as it had been in the recent past, although predictions about the price of uranium were difficult to make, and a prudent approach in assessing the outlook for it seemed appropriate.

Despite the importance of the uranium sector, Miss Le Lorier commented, Niger continued to be an essentially rural country, and there was clearly considerable potential for improving the agricultural and livestock sector, despite the difficult weather conditions in the region. The World Bank's emphasis on the further development of the agriculture and livestock sectors was appropriate, and the authorities' intention of sharply raising producer prices during the coming season was welcome. She wondered whether the magnitude of the increase had yet been decided.

The losses that had been incurred by a number of public and mixed enterprises were a cause for concern, Miss Le Lorier considered. She looked forward to examining both the preliminary results of the study on the public sector made by the ILO, and the study requested by Niger from the World Bank of the performance of the public enterprises. Given the lack of data on the enterprises, the studies were a prerequisite for the eventual rehabilitation of the public sector.

The fiscal deficit had increased sharply in 1979/80 and was expected to rise further in 1980/81 and 1981/82, Miss Le Lorier noted. It was likely to reach the equivalent of 6 per cent of GDP in 1981/82, and there was an urgent need to slow the rate of growth of expenditures, particularly in view of the high elasticity of the current account deficit with respect to the level of public investment expenditures. Assigning priorities to various investment projects on the basis of the relationship between the level of resources available and the volume of resources required for each project would be advisable. In addition, the level of subsidies should be kept under review; demand restraint would be required as part of the effort to make the adjustments that were needed to reduce the external imbalance. The staff had correctly noted that tax reform was warranted, and she wondered whether the Fund planned to provide technical assistance. The need for an improvement in the public sector position was reflected in the fact that previous fiscal deficits had caused an excessively rapid expansion of domestic liquidity.

The forecast overall balance of payments position was clearly unsatisfactory, Miss Le Lorier remarked. The overall deficit was expected to reach SDR 63 million in 1982--compared with a surplus of SDR 5.5 million in 1980--mainly because of the unfavorable trend in uranium prices. Furthermore, there had been a noticeable increase in the external debt, and total debt service payments, including private debt, were expected to be equivalent to 20 per cent of exports in 1981. She was pleased that the authorities attached considerable importance to monitoring the growing government and and government-guaranteed debt and had established the Directorate of

Public Debt in the Ministry of Finance. It might also be advisable to keep under review the level of private external debt with a view to avoiding the emergence of an excessively heavy debt service burden. In sum, the emergence of problems in both the fiscal and external areas, after a period of rapid economic growth, was a cause for some concern.

Mr. El-Khouri considered that Appendix II in SM/81/217, on the institutional aspects of the West African Monetary Union, was a useful contribution to the effort to examine the costs and benefits of membership in regional monetary arrangements. In addition, the staff representative from the African Department had written a useful article on the costs and benefits of monetary unions for the latest issue of Finance & Development.

He broadly agreed with the staff appraisal in SM/81/204, Mr. El-Khouri continued. Niger's balance of payments difficulties in 1981 had been caused partly by the unfavorable trend in uranium prices, and the difficulties were expected to remain in 1982. The authorities recognized that several corrective actions had been needed. They had, for instance, recently raised producer prices, which had been kept constant for some time, and they had asked the World Bank to examine the operations of the public enterprises and to review the targets under the Government's investment program.

Nevertheless, Mr. El-Khouri went on, the fiscal deficit continued to be a cause for concern; it had risen rapidly in the previous two years. The Government had increased expenditures during the boom caused by favorable uranium prices and had found it difficult to cut back when the price trend had subsequently become less favorable. Some expenditure restraint should certainly be exercised in the coming period, particularly with respect to wages and salaries in the government sector, subsidies, and capital expenditures by the Government. The deterioration in the balance of payments could be arrested if the authorities stepped up their vigorous effort to implement appropriate corrective measures.

The staff representative from the African Department explained that in Niger the price of uranium was determined by negotiations between the country and the relevant holding companies from France, Italy, and Germany. It was difficult to predict the outcome of the negotiations, which took place at the end of each calendar year and established the price for the coming year. The price trend up to 1981 had been favorable, but the price had dropped by nearly 20 per cent in 1981, mainly because of the excess supply of uranium on the international market. Similar conditions were expected to persist through the 1980s. However, the price of uranium in nominal terms need not necessarily decline in the coming period, and, indeed, the staff had projected an increase in 1981. Preliminary information, which had just become available to the staff, suggested that the negotiated price for 1982 would be somewhat higher than the staff had previously assumed; if that figure was correct, the staff projections for the budget, the balance of payments, and the debt service ratio would be somewhat lower than the figures in the present staff report, but the general trend would be unchanged.

In its report, the staff representative went on, the staff had consolidated the budgetary and extrabudgetary expenditures for the first time. In the past, the authorities had compiled budget figures for the Central Government alone, and there had been a persistent balance. However, there had been considerable extrabudgetary expenditures by the Ministry of Planning and other ministries, which had not been included in the central government budget. The staff's preliminary estimates of the consolidated budget had proved to be useful to the authorities. The large increase in the budget deficit in 1979/80 had been caused mainly by the weakening in the price of uranium, and the authorities were fully aware of the need to mobilize domestic revenues to close the gap. In 1980/81 they had introduced several revenue measures, including increases in taxes on profits and rents and a withholding tax of about 30 per cent on the income of nonresidents. In 1980/81, however, revenues were expected to increase by only about 9 per cent while total expenditures were estimated estimated to rise by approximately 12 per cent, thereby causing a further widening of the budget deficit. The trend was expected to continue in 1981/82, and the authorities were studying possible ways of mobilizing more domestic resources. They had asked the Fund for assistance in preparing a tax survey to determine the best possible ways of reforming the tax system, both to increase its income elasticity and to expand the revenue base. A technical assistance mission was expected to visit Niger in the near future.

A study by the ILO of the public enterprises in Niger had identified the problems facing each enterprise but did not reached any general conclusions about the sector as a whole, the staff representative commented. The authorities had asked the World Bank to prepare a detailed study on the public enterprises and to recommend steps that could be taken to improve their position. During the consultation discussions, the authorities had said that basically they were determined to keep in operation only those public enterprises that were felt to be efficient as measured by their profitability. However, they had also indicated that some of the enterprises provided important social services, and that their operations should not necessarily be expected to be profitable, although every effort should be made to ensure that they too operated efficiently.

Recent information, the staff representative continued, showed that the authorities planned to double producer prices of agricultural products in the 1981-82 crop year. During the discussions, the authorities had clearly recognized the need to provide additional incentives to the agricultural sector. However, they felt that the sector was already receiving considerable subsidies for fertilizers and other imports accounting for about 40 per cent of the cost of agricultural products, and that the level of incentives being provided to the sector could not be measured by producer prices alone. In any event, they had also noted, the producer prices involved were mainly those paid by official government agencies; a number of producers sold a considerable proportion of their total output in the market at prices not regulated by the Government.

The authorities, the staff representative from the African Department said, were studying the possibility of reducing the original investment targets in the development plan as a part of the effort to reduce the recourse to external borrowing and to slow the rapid rate of increase in the debt service ratio. In that context, they agreed with the staff on the need to identify high-priority, high-yielding projects.

Mr. Alfidja commented that the negotiated price for uranium for 1982 was higher than had originally been expected. It should have a favorable effect on the budget, as the authorities, in keeping with their cautious approach to fiscal policy, had not taken an increase in the price into account in estimating future revenues from uranium exports. The new price should also help the balance of payments position. Moreover, the World Bank had already stationed a resident representative in the country and was preparing studies on the public enterprises and the public debt.

Commenting on the authorities' investment policy, Mr. Alfidja said that new investment was deliberately kept in line with the availability of funds from outside partners. Domestic resources for investment were channeled through the Fonds National d'Investissement, and concessional funds were sought from international institutions and partner countries. The authorities had decided to slow the pace of the implementation of the public investment program; the implementation of some of the projects in the 1979/83 Development Plan was to be delayed, and the volume of funds available under the Fonds National d'Investissement in 1981 was to be kept at the same level as in 1980. Total investment funds had been divided into two elements, namely, the approximately CFAF 10 billion in domestic resources to be used for projects that had already been started, and whatever concessional borrowing was available. Certain projects would be implemented only if there were concessional financing to cover their costs. The level of foreign assistance to Niger had not increased in the period in which uranium prices and domestic resource availability had been favorable, but, with the decline in the price of uranium, the authorities had begun to explore possible sources of concessional financing.

The authorities had decided to close three public enterprises even before the World Bank had undertaken its study of the public enterprise sector, Mr. Alfidja remarked. The authorities' policy was to keep in operation only the enterprises that were profitable, with the exception of certain of them that provided important social services. Finally, two staff missions were scheduled to visit Niger in 1982, one to study the tax system, and another to continue the work on a consolidated budget. The first attempt by the staff at such a budget had certainly been useful.

The Chairman made the following summing up:

Executive Directors expressed their broad agreement with the thrust of the staff appraisal of the economy of Niger. They noted that real GDP had grown rapidly during the period 1977-80, in part as a result of the investments made possible by rising uranium receipts. The rate of real GDP growth is expected to decline in 1981, mainly due to the leveling off in uranimum output. In view of both the stagnating receipts from uranium exports and the investment effort undertaken by the Government, it is expected that in 1981 the consolidated government deficit will increase, domestic credit expansion will continue at a high level, and the external position will weaken.

Executive Directors stressed the need for taking measures in 1982 aimed at readjusting economic and financial policies in the light of weakened uranium prices. In this context, they noted the importance of scaling down the investment outlays under the current Five-Year Development Plan in line with the availability of financial resources. To stimulate domestic production and improve resource allocation in the non-uranium sector, Executive Directors indicated that a liberalization of price controls would be desirable, as well as an appropriate increase in producer prices in the agricultural sector.

Executive Directors underlined the importance of curtailing the growth in government expenditure through a continued containment of civil service salary adjustments, a reduction of subsidies, and a cutback of budgetary and extrabudgetary capital outlays, as well as the need to review the tax system in order to expand the domestic revenue base and enhance its income elasticity.

In this connection, Directors welcomed the decision of the authorities to review the operations of public enterprises to determine their viability. An improvement in the overall government position should aid the authorities in reducing the rate of growth of domestic credit while allowing adequately for the credit needs of the private sector.

Directors shared the concern of the staff regarding the mounting debt burden and emphasized the desirability of reducing external borrowing on nonconcessional terms. They welcomed the Government's adoption of measures to monitor borrowing abroad by the public sector and suggested that similar monitoring might be needed in regard to the private sector.

The Executive Board then turned to the proposed decision, which it approved.

The decision was:

1981 Article XIV Consultation

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

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

Decision No. 7021-(81/160), adopted
December 21, 1981

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Nagashima on the conclusion of his service as Alternate Executive Director for Japan.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by Executive Directors without meeting in the period between EBM/81/159 (12/18/81) and EBM/81/160 (12/21/81).

4. ARGENTINA - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/318, Supplement 1 (12/16/81). 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 January 29, 1982.

Decision No. 7022-(81/160), adopted
December 18, 1981

5. THAILAND - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/322 (12/14/81). 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 Thailand until not later than December 28, 1981.

Decision No. 7023-(81/160), adopted
December 17, 1981

6. MALAYSIA - TECHNICAL ASSISTANCE

In response to a request from the Malaysian authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/81/323 (12/15/81).

Adopted December 18, 1981

7. EXECUTIVE BOARD TRAVEL

Travel by an Advisor as set forth in EBAP/81/389 (12/17/81) is approved.

APPROVED: June 10, 1982

LEO VAN HOUTVEN
Secretary