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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/132

10:00 a.m., October 14, 1981

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

Executive Directors	Alternate Exective Directors
M. Abdollahi	
	C. Taylor
	S. E. Conrado, Temporary
	H. G. Schneider
R. D. Erb	
	S. R. Abiad, Temporary
	A. Nagashima
J. C. Iarezza	
	M. Casey
	G. Jauregui, Temporary
B. Kharmawan	V. Supinit
	F. Sangare
	J. U. Holst, Temporary
G. Lovato	
	A. Le Lorier
	C. Bouchard, Temporary
M. Narasimham	D. L. Kannangara
	S. El-Khouri
	A. Halevi, Temporary
	B. Legarda
J. Sigurdson	
	Jiang H., Temporary

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; R. Franco, C. A. François, S. M. Nsouli, E. Sacerdoti. Exchange and Trade Relations Department: S. Kanesa-Thasan. Legal Department: J. V. Surr. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: C. J. Batliwalla, A. B. Diao, P. D. Peroz, F. Yeo T. Y. Assistants to Executive Directors: L. Barbone, R. J. J. Costa, F. Guena, J. M. Jones, P. Kohnert, J. E. Leimone, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. G. Pederson, C. N. Pinfield, D. I. Shaw, H. Suzuki, O. Üçer, J. F. Williams, A. Yasseri.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. El-Khouri, Alternate Executive Director, to the Executive Board.

2. ALGERIA - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Algeria together with a proposed decision concluding the 1981 Article XIV consultation (SM/81/186, 9/14/81; and Cor. 1, 10/9/81). They also had before them a report on recent economic developments in Algeria (SM/81/192, 10/9/81).

Mr. Abdollahi made the following statement:

> The Algerian economy enjoyed a rapid rate of growth in 1974-78, mainly as a result of development planning based on an ambitious investment program incorporated in the Second Four-Year Development Plan of 1974-77. The objectives of this Plan, which have been met to a great extent, were basically the expansion of the hydrocarbon sector as the main source of financing for the overall development program, and the strengthening and diversification of the industrial base of the economy. However, as in many other developing countries, in particular the oil producing countries that had followed the path of rapidly building up the industrial base of their economies, bottlenecks and distortions had developed in Algeria's economy.
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> Although most sectors of the economy demonstrated a respectable growth performance, the nonhydrocarbon sector, in general, did not fully respond to large investment efforts. The growth in some important sectors, such as agriculture, infrastructure, and housing, lagged considerably behind growth in the industrial sector, creating shortages and bottlenecks. The 1978-79 period was used by the authorities to take steps to consolidate their achievements and to minimize any possible adverse effects of the Second Plan, as well as to assess and re-evaluate the problems associated with the implementation of the Plan. In the meantime, while some corrective measures were being taken, the economy continued to demonstrate a strong performance in 1979.
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> The result of this transitional period was the emergence of the Third Five-Year Plan for 1980-84, which incorporated a new set of development priorities. The major objectives of the Third Plan include balanced sectoral growth and more balanced growth of investment and consumption. The average annual growth of consumption is projected at 9 per cent, which is about the same as in the previous Plan. Annual growth in real investment is projected to decline to 7 per cent from 18 per cent in the Second Plan. However, the lower investment rate will be accompanied by greater efforts to complete existing projects. Increased efficiency and productivity will ensure higher economic growth.

The hydrocarbon sector continues to play its major role in the economy. Following the adoption of a policy of energy conservation and a shift toward the export of finished petroleum products, crude oil production declined by 10 per cent in 1980 and is expected to decline by 10-15 per cent in 1981. In view of the high cost and advanced technology required to run the gas liquefaction plants, development of natural gas will be phased out over the longer period and even further resort will be made to technologically simpler practices.

The industrial sector has been one of the fastest growing sectors of the economy with an average annual rate of growth of 8.4 per cent during 1974-78 and more than 20 per cent during the period 1978-79, due to the rapidly rising level of investment. However, the growth rate in industrial output responded only partly to the heavy investment efforts in this sector, mainly due to delays in project implementation, large cost overruns, and other bottlenecks.

Under the Third Plan, the amount of investment allocated to industry has declined. However, investment outlays on industry and energy will still absorb 35 per cent of all investment expenditures, and emphasis will be given to new projects in the "shortage" sectors, the completion of existing projects, raising labor productivity, and removing existing production and distribution bottlenecks. Furthermore, the authorities are convinced of the need to restructure public enterprises, by giving them greater financial and managerial autonomy, and by decentralizing some of the large conglomerates.

Increasing attention has been focused on agriculture in the past two years. A greater share of investment has been devoted to agriculture in the Third Plan. However, the authorities are considering a comprehensive reorganization of agriculture in line with the priorities of the current Development Plan. New, smaller agricultural units will be given a greater degree of managerial autonomy with regard to production, marketing, and distribution, and private farming will be encouraged. The authorities have already taken steps to remove any rigidities and obstacles in the production and distribution of agricultural products. Adequate tax relief and other incentives will be introduced.

There was a marked improvement in the current account of the balance of payments, which registered a surplus of SDR 186 million in 1980 compared to a sizable deficit in 1979. Owing to a need to maintain imports at a high level in order to satisfy legitimate consumer and domestic needs, the current account is expected to move to a moderate deficit in 1981, partly as a result of higher interest payments on existing foreign debts. However, the anticipated capital flow will compensate for this moderate deficit on the current account so that the level of foreign official reserves will only change slightly from that at the end of 1980. The use of foreign loans, which was sharply reduced in 1980, is expected to continue to decline, and there was no recourse to the international private capital market in 1980. External debt outstanding as a proportion of GDP declined in 1980 and will decline further in 1981.

On the fiscal side, the picture is encouraging. But in 1980, despite a sharp increase in hydrocarbon export receipts, the increase in the budgetary surplus was insufficient to finance the increase in investment and the overall treasury deficit rose to 4.5 per cent of GDP. In 1981, total government revenue and budgetary expenditures are projected to increase by some 25 per cent, the former as a result of increased hydrocarbon tax revenue and the latter on account of rises in wages and salaries, public enterprises, and capital expenditure. The projected rise in capital expenditure stems in part from the effort by the authorities to rebuild the town of Ech Cheliff, which was devastated by an earthquake in 1980. Loans and advances to public enterprises are expected to be close to the 1980 level.

Although the overall treasury deficit in 1981 will be as large as in 1980, its proportion to GDP will decline and total domestic credit will decelerate, reflecting less growth in credit both to the Government and to the remainder of the economy.

The authorities acknowledge the staff's concern regarding the recent trends in current budget revenues and expenditures. However, they maintain that these trends are transitional and are the result of the deliberate and unavoidable policy measures that have been adopted. Furthermore, they are confident that, with the implementation of the fiscal policies to be adopted for the period 1980-84, the trends will be reversed in the medium term.

Mr. El-Khouri considered that the Algerian authorities' exchange rate policy in general, and the exchange rate premium applied to remittances of Algerians working abroad in particular, were the two main points for discussion. The staff had stated at the end of its appraisal that "the exchange rate policy pursued by the Algerian authorities has maintained the nominal exchange rate of the dinar relatively stable and has limited the adverse effects of exchange rate fluctuations on domestic costs and prices. Nevertheless, as this policy has led to an appreciation of the dinar for the nonhydrocarbon sector, the authorities should not discount the potential benefit of a more active exchange rate policy to diversify the export base over the medium term." The statement was vague, because it gave no indication of what alternative policy the staff was suggesting. Furthermore, if the major aim was to diversify the export base over the medium term, the fact that nonhydrocarbon exports were on average only about 3 per cent of total exports during 1978-80 suggested that not much would be gained from such a policy. There was also the question of the cost of following an alternative exchange rate policy. In sum, the issue had not been thoroughly analyzed.

Similarly, any decision by the authorities to remove the exchange rate premium on remittances would have consequences that should be made clear, Mr. El-Khouri continued. The staff had not specified whether it was recommending the removal of the premium with or without a simultaneous exchange rate depreciation. Moreover, no reference had been made to the impact on the flow of remittances through official channels if the premium was removed. In addition, although the staff had recommended that the authorities should seek other means of encouraging workers' remittances than the use of an exchange premium, it had not described such ways and means. Finally, the staff seemed to have dismissed the authorities' concern about maintaining the purchasing power of the families that emigrants had left behind in Algeria. A more thoughtful analysis of the implications of removing the premium was warranted, especially as the staff was not recommending that the Fund extend its approval of the multiple currency practice.

It would also be helpful if the staff could express a view as to whether or not the Five-Year Development Plan for 1980-84 was compatible with financial stability in the medium term, Mr. El-Khouri added. There was no substantive discussion of the macroeconomic financial implications of the Plan in the staff reports. In addition, while the volume of natural gas exports had declined significantly in 1980--presumably because deliveries to the United States and France had been suspended in the spring of 1980--it was projected to rise sharply in 1981, despite the continued suspension of deliveries to the United States. He asked, first, whether U.S. imports of natural gas from Algeria were small, and second, whether there had been any developments with respect to the price agreement between the two countries.

Mr. Abiad said that the Algerian authorities should be congratulated for the sound economic and financial policies they had adopted in the past two years in order to redress the imbalances and distortions that had emerged during a long period of intensive development efforts. The economy had on the whole performed satisfactorily in 1980. A respectable rate of growth of real GDP had been maintained, although it had been lower than in previous years mainly on account of the slower growth of the hydrocarbon sector, reflecting the authorities' new conservation policies. The rate of price increase had slowed down. The balance of payments had been considerably strengthened, showing a surplus on both current and overall account. The year had also been marked by the stabilization of the level of outstanding external debt, in absolute terms, and its decline as a proportion of GDP, as a result of the policy of reducing recourse to international financial credit on commercial terms. Other developments during the year included the introduction of measures to alleviate some of the rigidities in public sector enterprises, so as to improve their financial structure and to raise labor productivity.

With respect to the outlook for 1981, Mr. Abiad continued, the rate of growth of real GDP was expected to accelerate--although the staff felt that the official estimate might be on the high side--and the overall treasury deficit as a proportion of GDP was expected to decline.

Inflation, according to the staff reports, was also expected to remain close to the 1980 level. In that connection, it would be useful if the staff could elaborate on the behavior of the GDP deflator assumed in the figures in both Table 1 and Appendix III of SM/81/186, because the rate of growth of nominal GDP seemed to be expected to fall significantly between 1980 and 1981, while the rate of growth of real GDP was expected to accelerate appreciably.

For the medium term, the authorities' intended policies seemed to be well designed and to go in the right direction toward achieving a reduction in reliance on a single export sector and an acceleration in the diversification of the productive base of the economy, Mr. Abiad commented. Those policies seemed, rightly, to pay great regard to the country's absorptive capacity and factor endowment, and if fully implemented could lead to greater utilization of existing capacity and resources, consequently permitting the elimination of the resource gap.

As for exchange rate policy, Mr. Abiad added, the staff had pointed to the need for export diversification as a major justification for greater use of the exchange rate instrument. It was quite possible that the cost and price structures in some open developing economies could be brought closer in line with the export diversification and import substitution objectives through exchange rate adjustments. However, in the case of a dual economy like Algeria's, which was based on oil and was also centrally planned, the effectiveness of exchange rate policy was constrained by a number of considerations relating, inter alia, to the elasticities of supply and demand for exports and imports and to administered pricing systems. Exchange rate modification in such economies could entail undesirable social and economic effects. His chair was therefore inclined to agree with the authorities' view that export diversification, as one aspect of the desired improvement in the allocation of resources, could be achieved through a properly balanced mix of domestic policies aimed at rationalizing investments, increasing imports, raising productivity, and improving the effectiveness of fiscal policy. The question of the effectiveness of exchange rate policies in developing countries in general, and in oil exporting countries and centrally planned economies in particular, had been raised in the Executive Board on numerous occasions, and it was still open to debate.

The exchange rate premium on workers' remittances had also been questioned by the staff, Mr. Abiad noted. That form of multiple exchange practice could hardly be viewed as a source of serious concern, given its negligible impact on Algeria's major trading partners and the rest of the world. There was some merit in the authorities' belief that the premium performed social and economic functions that went beyond the questions of import availability or the convertibility of the dinar.

Miss Le Lorier noted that the 1981 Article IV consultation with Algeria provided a good opportunity to assess the performance of the economy at a time when the country was pursuing a new economic policy under the current Development Plan for 1980-84. The satisfactory performance of the economy during 1980 and the good prospects for 1981 were described clearly in the staff reports, as were the medium-term economic policies currently being implemented by the authorities.

For 1980, GDP had grown by only 3.8 per cent, Miss Le Lorier commented, which seemed low compared to a 7 per cent average rate of growth in the period 1974-79. However, the slowdown reflected in large part a sharp drop in output of the hydrocarbon sector, whereas nonhydrocarbon production had risen by 9.1 per cent in 1980, an impressive achievement. The forecast for 1981 of an increase in GDP of 8.7 per cent seemed promising.

Referring to the fiscal sector, Miss Le Lorier noted that the current budget surplus had increased by nearly one third, reaching 23 per cent of GDP in 1980, and was predicted to remain at the same level for 1981. However, as had been brought out in the staff paper, 60 per cent of total budget revenue was drawn from receipts from hydrocarbon exports, and the budget prospects for 1981 might be affected by the continued suspension of deliveries of liquefied natural gas to a major U.S. customer. Additional details from the staff in that respect would be helpful. As for monetary developments, she had noted with interest that the ratio of broad money to GDP had declined since 1979, reversing a long standing trend.

The overall balance of payments for 1980 had been in surplus by SDR 1 billion--a good result--Miss Le Lorier considered, but the forecast for 1981 showed a small deficit of SDR 68 million mainly due to increased imports, which were expected to rise by 32 per cent in terms of SDRs. There was always the hope that the small deficit would be temporary and would turn into a surplus in the following year, but it was clear that balance of payments performance would continue to depend chiefly on export receipts from the hydrocarbon sector.

The authorities were to be commended for the new medium-term economic policies they were currently implementing, Miss Le Lorier continued. Those policies were aimed at the reorganization and restructuring of the productive sector, the development of a new investment strategy, and a new policy toward the hydrocarbon sector. She shared the staff's view that the restructuring of the productive sector--and within that sector of public enterprises--was crucial; the efforts already undertaken by the Algerian authorities through the newly established National Committee for Enterprise Restructuring were commendable. She had noted in particular that the restructuring of several public enterprises, including such large ones as SONATRACH and SONACOME, had already been decided upon. As for investment policy, the priority given to the processing of output in the hydrocarbon sector seemed appropriate, as did the focus being placed on housing and water supply, on a somewhat lagging agricultural sector, and on projects that were relatively labor intensive.

On the whole, Miss Le Lorier concluded, the Algerian economy appeared to be developing satisfactorily and she was confident that the new measures being implemented would foster rapid development of the country.

Mr. Taylor said that he was in general agreement with the staff appraisal. The broad direction of the authorities' medium-term policies set out in the Five-Year Development Plan seemed appropriate, and if those policies were successfully implemented, a firmer basis for more balanced economic growth should be established. The greater attention being paid to the agricultural sector was particularly welcome; its comprehensive restructuring into smaller units, combined with greater flexibility in the provision of services to producers and in marketing, along with the formation of an agricultural bank, should help to improve agricultural productivity and output. However, if those reforms were to succeed, it was important to underpin them with an appropriate structure of producer prices and a flexible wage framework. Consequently, he hoped that the incomes policy that was currently under preparation would contain that essential flexibility. He would be interested in any further elaboration of the authorities' policy on producer prices.

On industrial restructuring, Mr. Taylor continued, the reorganization and decentralization of a number of enterprises, and the emphasis being given to development of the private sector, seemed appropriate in view of the bottlenecks and the low utilization of capacity in the economy in recent years. It appeared desirable to formulate clear guidelines defining the area of private sector activity as soon as possible; he hoped that those guidelines would be accompanied by a shift toward economic pricing in both the public and the private sectors. The successful expansion of private sector activity would depend on the provision of new credit facilities, which the authorities proposed to introduce. In that context, a realistic interest rate policy would be important because the continuation of highly negative real interest rates could lead to a misallocation of resources in the developing private sector as well as in the increasingly decentralized public sector.

The authorities were expecting an enlargement of the tax base in the medium term, Mr. Taylor observed, but an immediate weakening of the fiscal position might occur if, as seemed probable, hydrocarbon receipts fell off. Given the possibility of some tax shortfall in the near term, he would be interested to learn whether or not there was any scope for accelerating the growth of non-oil revenues, which had been declining relative to non-oil GDP in recent years against a background of a rather rapid growth of wages and consumer expenditures. Action on the revenue side could be accompanied by tighter restraint on the expenditure side.

As for exchange rate policy, Mr. Taylor said that he agreed with the staff that stabilization of the nominal effective exchange rate could hamper efforts to diversify the productive base of the economy in the medium term. The emphasis on import substitution could make for a closed and inefficient economy. It was desirable for the exchange rate to serve as an accurate guide to resource allocation.

The possibly protracted shortfall in export earnings led him to inquire whether the projected growth of import volume was sustainable, Mr. Taylor added. In passing, he noted that the staff estimate in Table 2 of SM/81/186 of a 12 per cent increase in unit import prices in 1981 was surprising when set against the background of a 10 per cent appreciation in the dinar against its basket of currencies in the first half of the year; he would have expected a more modest increase in import prices.

The trade and payments system should be made more flexible as rapidly as possible, Mr. Taylor concluded. For his part, he supported the staff's recommendation that the authorities seek to encourage remittances from Algerians working abroad through domestic measures rather than by retaining the exchange rate premium; for instance, interest rates could be increased or convertible dinar accounts established for overseas workers. The authorities justified the continuation of the premium on social grounds, but the cost to the budget was projected to more than double between 1980 and 1981. Were there any specific reasons for the rather significant increase in the cost of the premium?

Mr. Erb said that the basic outlines of Algeria's new medium-term development strategy appeared reasonable. Some aspects of that policy that could prove troublesome had already been mentioned. First, the fact that the Algerian economy was characterized by price controls and subsidies probably meant that the lack of good price information had been an underlying cause of the misallocation of resources that was reflected in low productivity, significant idle capacity, and the weak financial position of many firms. Thus, he would appreciate the staff's comments on the extent to which the current reforms would incorporate improved pricing policies. He also inquired whether present attempts to harmonize wages on a national scale might not have the undesirable result of eliminating the wage differentials needed to attract labor to those geographic regions and productive sectors where it would yield the highest rates of output.

Second, Mr. Erb remarked that he agreed with Mr. El-Khouri that further work needed to be done by the staff on the question of what would be an appropriate exchange rate policy for Algeria, given its objective of wanting to increase non-oil exports. The current policy of maintaining the nominal exchange rate of the dinar relatively stable had led to its appreciation for the nonhydrocarbon sector. That development was having effects that were contrary to the authorities' goal of limiting the current account deficit, excluding the hydrocarbon sector.

Finally, Mr. Erb joined in urging the Algerian authorities to look for ways to eliminate the premium on workers' remittances from abroad, and to take early action to eliminate the two bilateral payments agreements with Fund members.

Mr. Lovato commented that if the current forecasts proved correct, the Algerian economy, after slowing down in 1980, would record sustained growth and be characterized by other positive developments. He agreed with the staff view, shared by the Algerian authorities, that for several years to come the main policy concern should be to reduce sectoral imbalances and to ensure a better use of the productive capacity that had been developed over the past years of high investment expenditures.

In particular, efforts currently under way to modernize the productive structure of state agricultural enterprises were commendable, given the dismal performance of agriculture in the past, and the fact that expenditure on consumption goods had been stimulated by the large wage increases granted in the past two or three years, as evidenced by the 44 per cent increase in imports of foodstuffs.

The restructuring of the large conglomerates operating in the industrial sector, to be implemented under the current economic plan, also appeared necessary as a way of overcoming the low level of utilization of productive capacity, Mr. Lovato observed. In that respect, the good productivity performance of heavy industry in the past three years indicated movement in the right direction toward overcoming the bottlenecks that had led to a relatively modest rate of growth of output as measured against the increase in productive capacity. However, the objective of the Plan in the construction sector seemed somewhat ambitious, especially considering the low number of starts mentioned in the staff report.

There was still cause for concern about the economy, Mr. Lovato remarked. First, the high debt service ratio, together with the likely increase in the current account deficit of the balance of payments, might become a serious problem in the years ahead. He wondered whether the authorities were considering corrective measures to forestall that situation. Second, neither the large wage increases in the past year nor the exchange rate mechanism currently in use had led to the growth of a manufacturing sector capable of contributing to exports in coming years. He wondered what attention the Algerian authorities were giving to that problem, which was obviously one for the long run.

A difficult question that arose, and that had been addressed only marginally in the staff report, was that of the appropriate pricing policy for natural gas exports, Mr. Lovato added. The authorities understandably were trying to maximize their revenues from the country's natural resource. However, they should pay acute attention to the medium-term and long-term effects of the aggressive pricing policy that they seemed determined to pursue. As the staff had emphasized, export receipts from natural gas would play an ever increasing role in the Algerian balance of payments. Both the relatively small amount of known crude oil reserves and the unlikelihood that exports of goods other than hydrocarbons would become an important item in Algeria's external trade made natural gas the country's most valuable asset. The attempt to raise the price to the equivalent of the oil price would entail generating the possibility of a shift toward the use of alternative energy sources in the medium term, quite apart from world inflation. The high targeted rate of growth of GDP for the years ahead depended on the possibility of substantially expanding the volume of natural gas exports, and if future development plans were not to be imperiled, pricing policy should take accurate account of all the risks involved.

Finally, Mr. Lovato agreed with the staff that the present multiple currency practice relating to remittances did not seem justified by balance of payments considerations. The growing burden that the premium constituted for the Government's budget gave added weight to the argument that the authorities should find alternative methods that did not interfere with the external payments system.

Mr. Legarda concluded from the staff report that the implementation of the 1980-84 Development Plan was critical to Algeria's future prosperity, against a background of a high level of external debt servicing and relatively low efficiency and productivity in the nonhydrocarbon sector. Despite a doubling of oil prices between 1978 and 1980, the current account was expected to show a deficit again in 1981. However, the measures taken thus far appeared to be broadly appropriate, and in most respects production and investment were proceeding as planned. The restructuring of the agricultural sector to make its operations more flexible, including measures to reduce government involvement in distribution and marketing and the establishment of an agricultural bank, was welcome.

Mention had been made in the staff reports of the rather large share of infrastructure expenditure that public enterprises had previously had to bear, Mr. Legarda noted. Under the new system, that expenditure would probably be assumed by the general budget so that public enterprises could concentrate on meeting direct production costs. However, it was clear from a comparison of the targets for the 1980-84 Plan, shown in Table 3 of SM/81/192, with figures on recent performance in Table 1 that consumption and imports were growing at rates considerably above the targets. It would probably be inconsistent with the centrally planned nature of Algeria's economy for the authorities to give greater scope to the price mechanism in order to influence patterns of investment and consumption. They had agreed, for instance, that high interest rates would have a positive effect in mobilizing additional savings but were concerned about the consequent adverse impact on the financial situation of the heavily indebted public enterprises, as noted on page 14 of the staff report (SM/81/186). The reforms being undertaken in the management and structure of those enterprises might nevertheless make it possible for them to pay a more market-oriented interest rate, and financial intermediaries could thus also offer a higher interest rate reward on deposits or on placements with them.

As far as the exchange rate was concerned, Mr. Legarda added, an inadequate case had been made for the view expressed in the staff paper. It was stated on page 3 of SM/81/186 that "the nonhydrocarbon sector, which represents two thirds of total value added, continued to expand at a sustained rate of around 9 per cent, spurred by rapid growth, in particular in manufacturing but also in construction and services." There was a further reference on page 14 of the same report to the continued high rate of growth in the nonhydrocarbon sector. Yet in its appraisal the staff had drawn attention to the appreciation of the dinar for the nonhydrocarbon sector, suggesting that "the authorities should not discount the potential benefit of a more active exchange rate policy to diversify the export base over the medium term." It seemed to him that if the nonhydrocarbon sector was growing satisfactorily on a micro level, across-the-board macro use of the exchange rate was not justified. The existing problems of inefficiency and low productivity could be solved gradually by restructuring the economy and by internal measures, such as the investment and import programs, and the fiscal policy described on page 15 of the staff report.

He shared the skepticism of the staff about the continued use of an exchange rate premium to stimulate workers' remittances, Mr. Legarda stated, especially as the Algerian authorities recognized that they were not acting for balance of payments reasons. Mr. Taylor had already mentioned the possibility of convertible dinar accounts or higher rates of interest on domestic deposits. Other devices had been used by countries facing a similar problem, such as permitting the families of those receiving remittances to hold foreign currency balances.

Mr. Narasimham joined others in commending the Algerian authorities for the way in which they had managed their economy recently and for the many measures taken to restructure economic institutions, both in agriculture and industry.

On the exchange rate, he was inclined to agree with Mr. El-Khouri and Mr. Abiad. The suggestions made by Mr. Taylor of offering higher rates of interest or the possibility of holding convertible currencies begged the question in the sense that they were based on the assumption that the remittances would be deposited in Algeria, whereas they were presumably destined for purposes of family support. It was for that reason that the authorities justified the premium on social rather than on balance of payments grounds.

The staff representative from the African Department explained that the preliminary estimates in the 1980-84 Development Plan did not include precise medium-term balance of payments forecasts. However, the assumption under the Plan was that the current account deficit would remain low over the coming few years in comparison with past deficits. If that assumption was realized, exports would increase in constant prices by about 4 per cent, the increase in imports would be limited to 6 per cent, and the current account deficit would be equal to about 1 per cent of GDP. In the staff's view, the balance of payments prospects would depend on a number of policy variables and elements, several of which were crucial: first, the prospects for the volume and price of hydrocarbon exports; second, investment policy; third, policy regarding consumption; and fourth, the pace of improvements in the efficiency of the economic system as envisaged under the Plan. With respect to export prospects, it seemed reasonable to assume, in accordance with the Plan, an increase in volume of about 4 per cent annually over the next ten years, corresponding to a decline in the production of crude oil at an average annual rate of about 2 per cent, to be offset by a rapid increase in the output of natural gas at an average annual rate of 17 per cent. Those estimates excluded any improvement in the terms of trade other than the adjustment in the price of natural gas to oil parity. The average price of natural gas had been about $3.50 per million BTU in 1980, with a substantial increase to at least $5.50 per million BTU expected before the end of 1981 or early in 1982 as a result of current negotiations. Agreements had already been reached with some countries, including Belgium, and negotiations were proceeding with France and Italy.

As for investment policy, the staff representative continued, the Algerian authorities were serious in their intention to reduce the rate of increase of investment in coming years, so that there should not be a large increase in aggregate demand due to investment; in fact there might be a tendency for investment policy to be excessively cautious following a period of rapid investment. It was assumed under the Plan that the increase in consumption would not exceed 9 per cent, a slightly higher rate of increase than had been recorded in the past; but the planned target might be exceeded due to the large increase in income generated by economic growth and the accumulation of liquidity in the economy. Finally, it was likely that the pace of improvement in the efficiency of the economic system and in productivity in general might have been overestimated in the Plan. Thus, the sizable gain that was expected in terms of import substitution, which might still be realized in the long term, might not be fully achieved during the period 1980-84.

One of the assumptions of the Plan was that the rate of capacity utilization would increase from 60 per cent in 1979 to about 80 per cent over the period of the new Plan, the staff representative noted. It was also assumed that agricultural output would increase significantly; although there was scope for such an increase, it was not yet evident that it could be achieved within such a short period of time. Therefore, despite a slowdown in the rate of increase in investment, aggregate demand might increase more than domestic production, and the need for imports would thus be greater than envisaged in the Plan, and the potential resource gap--at least in constant prices--might be larger than envisaged. However, account had to be taken of the possibility that the terms of trade might improve substantially in coming years. In addition, Algeria had the possibility of increasing the volume of output of petroleum and natural gas, and also had the option of restraining growth in consumption, as in the past, by tightening restrictions on imports and trade. In any event, one of the basic objectives of the Algerian authorities was to reduce recourse to foreign borrowing in the future. To meet that objective, they would certainly make an all-out effort to improve the efficiency of the economic system and to contain the growth in consumption.

Exchange rate policy in general was clearly an important but difficult issue, the staff representative observed, although at the present stage it raised theoretical rather than practical problems. The staff had tried to express a cautious view in its appraisal because it did not believe that Algeria's problems could be solved by a change in the exchange rate. As had been noted during the discussion of the 1980 Article IV consultation, Algeria was in a special situation; it was an oil producing country with strong export prospects; its economy was centrally planned; yet it was at an early stage of industrialization, and was thus experiencing the usual problems with infant industries. The level of production costs for each new unit of output, owing to a number of problems described in the staff reports, was substantially higher than that of partner countries, and not because of differential rates of inflation. That was true not only in the industrial but in the agricultural sector. It should be noted that agricultural producer prices were quite high in Algeria, having been increased regularly over the past ten years; the cost of domestically produced cereals was 60 per cent higher than the cost of imported cereals. For the nonhydrocarbon sector, the cost distortions were partly due to the exchange rate, but in general they had to be corrected by a combination of measures and policies, and not solely through the exchange rate. A somewhat more flexible domestic pricing policy was necessary, but it would take some time to increase productivity. Therefore, the staff had taken the position that in the years ahead the Algerian authorities should not ignore the role that the exchange rate could play in their policy of restructuring the economy and enhancing its efficiency.

As for the premium on workers' remittances, the staff representative observed, the staff had found it difficult to recommend continued approval of the multiple exchange practice, in part because of the views expressed by many Executive Directors during the discussion of the 1980 Article IV consultation. In addition, the sharp appreciation of the dinar vis-à-vis the French franc during 1981 had more than doubled the size of the premium, and the cost for the budget had also increased substantially. Also, the reasons for maintaining the premium were increasingly social rather than economic. While the authorities in the past had stressed the need to limit exchange transactions with respect to private compensation, during the recent consultations they had stressed the need to stabilize the income of families remaining in Algeria. Moreover, the premium had not led to an increase in workers' remittances, which had remained practically at the same level over the past several years. The remittances for the most part took the form of goods carried by Algerian workers, the value of which accounted for a significant proportion of total imports into Algeria of consumer goods, mainly luxury items that could not be imported under the official import system. Admittedly, the staff did not have a practical replacement to offer to the Algerian authorities for the premium. But because the premium was in effect a social transfer from the budget to a segment of the population, the staff had taken the position that other instruments than the exchange rate should be used to meet that objective. Social transfer payments should not be effected through the balance of payments, but through the budget, and the introduction of convertible currency accounts or increases in the interest rate would therefore not solve the immediate problem.

Account was taken in the national wage policy introduced by the Algerian authorities of some regional differentiation, the staff representative said. However, the system of wage determination was not sufficiently flexible to permit full allowance to be made for the numerous factors that could decide the movement of the labor force.

The forecast increase of 12 per cent in the unit price of imports was in terms of SDRs, and not in terms of the dinar, the staff representative explained. For the time being, the dinar was not appreciating in terms of the SDR, and the staff felt that its import forecasts were reasonable. There was scope for increasing non-oil government revenue over the medium term through an improvement in tax administration and also perhaps through increases in some taxes in future. The sharp increases in oil revenue over the past few years had led to a weakened tax administration and it would take a number of years to redress the situation. The number of people involved in the collection of taxes had been reduced, and it would also be necessary to improve the tax code.

The increase in natural gas exports in 1981 was basically due to the recovery of exports to France, the staff representative from the African Department explained, because provisional agreement had been reached between Algeria and France on prices. The staff forecasts did not take account of any renewal of exports to the United States, nor did they include the export of natural gas to Italy through the pipeline.

The staff representative from the Exchange and Trade Relations Department recalled that since the 1980 Article IV consultation had taken place with Algeria, the Executive Board had held a comprehensive review of the Fund's policies pertaining to multiple currency practices, and had adopted a decision (Decision No. 6790-(81/43), adopted March 20, 1981), two aspects of which were pertinent to Algeria's situation. First, the Executive Board had reaffirmed that the Fund would approve multiple currency practices for balance of payments reasons provided that the member represented, and that the Fund was satisfied, that the measures were temporary. The Algerian exchange practice had been in force since 1974, and the member had moreover not represented that it was a temporary measure. That was the principal reason why approval of the practice was not being recommended. It was also relevant to note that Algeria's exchange premium was being maintained principally for non-balance of payments reasons. The Executive Board's decision required the Fund, in such instances, to urge members to apply alternative policies not connected with the exchange system. The proposed decision relating to Algeria's exchange measures reflected that position.

Mr. Abdollahi reiterated a point that had been made repeatedly in the Executive Board by most Directors representing developing countries: the exchange rate--and the interest rate as well--played a special role in centrally planned economies and in other economies in which governments were the largest economic enterprise, and also in developing economies that were heavily dependent on the export of primary goods. The exchange rate system had to be viewed as an instrument for achieving the development priorities of a country in question, rather than being considered as a feature of an open economy.

In brief, Mr. Abdollahi considered that exchange rate policy and the premium on workers' remittances posed questions that could be discussed only superficially unless a thorough study was made in each and every case. It was not sufficient to make recommendations based merely on the existence of a fixed exchange rate or of a premium on remittances maintained for non-balance of payments reasons.

The Chairman made the following summing up:

Executive Directors generally agreed with the thrust of the views expressed in the staff appraisal. They praised Algeria for the rapid rate of growth achieved in recent years through high rates of investment and savings and for the efforts pursued to diversify the economy. They noted the corrective measures implemented in 1979-80 and the improvement in the current account of the balance of payments, which enabled the authorities in 1980 to discontinue recourse to internationl financial credits and thus to be in a better position to ease the high debt service burden of the country. It was noted that broad liquidity in the economy had ceased rising in relation to GDP, a change from a long-standing trend. In view of the heavy reliance of the public finances on fiscal revenue from the hydrocarbon sector, some Directors felt that a more diversified taxation system would be appropriate to maintain an adequate level of domestic savings in the medium term.

Directors welcomed the emphasis that the authorities have put in the new Development Plan for 1980-84 on improving productivity and raising capacity utilization of the extensive industrial sector that has been built up in recent years. They felt that the reorganization of public enterprises currently under way and the more important role to be attributed to decentralized units of the public sector and to the private sector itself in the economic process could contribute significantly to the more efficient use of resources at which the authorities are aiming. Encouragement was given in this context to the use of realistic pricing policies and interest rates in order to offer more incentives for savings and investment, and to achieve a better allocation of resources. Directors welcomed the increased emphasis given in the Development Plan to developing those sectors of the economy that have lagged behind, such as housing, agriculture, and infrastructure, so as to gradually eliminate bottlenecks and ensure more balance growth. In this respect, special mention was made of the plans to encourage productivity in agriculture.

Directors also welcomed the easing of restrictions under the import regime as a result of a more flexible administration of controls and a larger allocation for imports of consumer good. Some Directors agreed with the staff that Algeria might derive benefits both from a more active exchange rate policy which, in their view, would contribute to a diversification of production and exports over the medium term, and also from the elimination of the exchange rate premium for workers' remittances. Other Directors, however, noted that they had great doubts about the effectiveness of the use of the exchange rate for that purpose, and suggested that a fuller and more explicit analysis was needed, in the specific conditions of Algeria, of the costs and benefits of a more active exchange rate of policy, and also of possible alternative means to encourage the inflow of workers' remittances.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision relating to Algeria's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1981 Article XIV consultation with Algeria, in the light of the 1981 Article IV consultation with Algeria conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Since the last consultation no changes have occurred in Algeria's system as described in SM/81/192. The Fund urges Algeria to explore alternative measures that would enable it to remove the multiple currency practice resulting from the premium on workers' remittances from abroad and to take early action to eliminate the two bilateral payments agreements with Fund members.

Decision No. 6968-(81/132), adopted
October 14, 1981

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/131 (10/9/81) and EBM/81/132 (10/14/81).

3. COMOROS - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/261 (10/7/81). 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 Comoros until not later than November 20, 1981.

Decision No. 6969-(81/132), adopted
October 9, 1981

4. EL SALVADOR - TECHNICAL ASSISTANCE

In response to a request from El Salvador for technical assistance, the Executive Board approves the proposal set forth in EBD/81/262 (10/7/81).

Adopted October 9, 1981

5. MALI - TECHNICAL ASSISTANCE

In response to a request from Mali for technical assistance, the Executive Board approves the proposal set forth in EBD/81/266 (10/8/81).

Adopted October 13, 1981

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/81/316 (10/8/81), EBAP/81/317 (10/9/81), and EBAP/81/318 (10/9/81) is approved.

APPROVED: March 10, 1982

LEO VAN HOUTVEN
Secretary