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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/6

10:00 a.m., January 17, 1992

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
G. K. Arora	L. E. N. Fernando
	Chen M., Temporary
C. S. Clark	G. C. Noonan
T. C. Dawson	Q. M. Krosby
	J. Prader
	F. Moss, Temporary
E. A. Evans	G. H. Spencer
R. Filosa	N. Kyriazidis
M. Finaish	A. F. Mohammed
I. Fridriksson	J. A. Solheim
H. Fukui	N. Tabata
	S. Shimizu, Temporary
B. Goos	B. Esdar
J. E. Ismael	
A. Kafka	
J.-P. Landau	I. Martel
	H. Dognin, Temporary
	O. Kabbaj
L. B. Monyake	
D. Peretz	R. Thorne, Temporary
G. A. Posthumus	
C. V. Santos	Y.-M. T. Koissy
A. Torres	R. Marino
	E. Martínez-Alas, Temporary
A. Végh	

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

<u>Also Present</u>
IBRD: F. S. Omar, L. De Wulf, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; P. A. Acquah, D. T. S. Ballali, N. Calika, J. A. Clement, P. Enwenczyk, T. T. Gibson, P. S. Heller, A. Lennblad, T. K. Morrison, M. C. Niebling, E. M. Ucer, U. Wilson, P. A. Youm. European I Department: G. C. Anayiotos, E. Spitäller. European II Department: E. Hernández-Catá, Deputy Director; J. Berengaut, A. Gagales, L. Hansen, S. Phillipps, T. Shikado. Exchange and Trade Relations Department: J. T. Boorman, Director; J. Ferrán, Deputy Director; T. Leddy, Deputy Director; F. C. Adams, A. Basu, M. E. Edo, B. E. Rourke. External Relations Department: S. J. Anjaria, Director; M. A. Seeger. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; T. M. C. Asser, H. Elizalde. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; R. S. Franklin, A. Leipold. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; D. Gupta. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, J. O. Aderibigbe, P. Bonzom, L. E. Breuer, M. B. Chatah, L. Dicks-Mireaux, B. R. Fuleihan, M. Galán, Y.-H. Lee, M. Nakagawa, D. Powell, F. A. Quirós, A. M. Tanase, S. von Stenglin. Assistants to Executive Directors: T. S. Allouba, D. A. Barr, T. Berrihun, B. Bossone, J. H. Brits, J. A. Costa, S. B. Creane, Deng H., Duan J., T. P. Enger, S. K. Fayyad, A. Giustiniani, H. Golriz, M. E. Hansen, K. M. Heinonen, K. Ishikura, J. Jamnik, J. Jonas, V. Kural, W. Laux, G. Lindsay-Nanton, R. Meron, M. Mrakovcic, J. A. K. Munthali, L. F. Ochoa, E. Quattrociocche, L. Rodríguez, S. Rouai, D. Saha, F. A. Sorokos, D. Sparkes.

1. BALTIC STATES AND OTHER FORMER REPUBLICS OF THE U.S.S.R. - COMMITTEE OF THE WHOLE ON MEMBERSHIP; AND FORMER REPUBLIC OF THE U.S.S.R. - COOPERATION

The Executive Directors had before them a statement made by the Managing Director at a previous meeting on recent developments and Fund activities in the former U.S.S.R. and related matters (EBM/92/3, 1/10/92).

The Managing Director noted that the two proposals that he had made in his statement and that were on the agenda for consideration concerned first, the discussion in a Committee of the Whole of the membership applications from the former republics of the U.S.S.R., given the commonality of the issues, their broad institutional importance, and their interest to the entire Board; and second, the interim arrangements that would enable the Fund to continue to cooperate with the former republics until the 1992 Annual Meetings. Those arrangements could be implemented in an exchange of letters between himself and the relevant authorities.

Mr. Dawson said that he could support the two proposals of the Managing Director. Establishing a Committee of the Whole to deal with the applications for membership would be practical, in view of the commonality of interest and of the problems. Likewise, continued cooperation with the republics until the annual meeting was a pragmatic approach that he hoped would be followed also by the World Bank.

Mr. Monyake remarked that basically he had no problem with the two proposals, although he wondered whether the Fund would have the resources to continue the arrangements for cooperation with the various republics without weakening its activities in other regions. He would like to be reassured that the Fund's activities with current members would not suffer.

The Managing Director responded that he could not offer full assurance because of the complexity of the issues. That did not mean that there would be any lessening of the Fund's strong commitment to continue its work in other parts of the world with the same determination and the same means as before. For reasons that had been discussed frequently, flexible as the institution was, rigidities were bound to be encountered along the way. It was the need to move with determination and pragmatism, but on safe, legal grounds, that had led to his proposal to amend slightly the existing arrangements for providing assistance to the former republics of the U.S.S.R.

Mr. Kabbaj made the following statement:

> We broadly concur with the Managing Director's proposals relating to the consideration of membership applications and to the adaptation of the Special Association Agreement to take account of the prevailing situation. We also agree, for the reasons outlined in the Managing Director's statement of

January 10, 1992, that "it would seem reasonable for the staff to issue for the consideration of the Executive Board a single paper dealing with the methodology to be employed and approaches that could be considered in making quota calculations." We look forward to the issuance of this paper.

We can also go along with the proposal to have the whole Executive Board, as a Committee of the Whole, deal with the applications for membership of the republics of the former U.S.S.R. instead of the usual procedure of forming separate Board committees. This will indeed allow for greater efficiency in terms of time saving and of ensuring evenhandedness vis-à-vis the 15 applicants or applicants to be.

With respect to the constitution of the usual ad hoc Executive Board Committee on the Rules for the 1992 Regular Election of Executive Directors (CREED), we believe that given the exceptional circumstances this year, the committee should be set up at the same time as the committee of the whole on membership is constituted, and that its work should be completed by the time of the Interim Committee meeting. We are of the view that the CREED should strive, inter alia, to preserve the present broad geographic representation in the Executive Board and that the accommodation of any new members should not be at the expense of the representation of developing countries in the Executive Board.

As to the composition of the CREED, we believe that it should be similar to that of formed committees, and would therefore recommend that endangered constituencies be represented. Another possible solution, which does not, however, have our preference, should be to set up a committee of the whole in order to take into account the likely high interest of all constituencies.

Finally, on the issues related to the Special Association Agreement, we perfectly understand the reasons for the Managing Director's proposal and we can support it. We understand that the World Bank does not face the same problem, and just for the sake of personal curiosity, we would be interested in any comment the General Counsel may have.

The General Counsel said that he would respond to Mr. Kabbaj's question after having consulted his counterpart in the World Bank.

The Managing Director said that he recognized the importance of the issues raised by Mr. Kabbaj relating to the forthcoming regular election of Executive Directors. At the same time, he noted that the Board's work on the methodology for the calculation of quotas and the applications for membership by the republics were issues of more immediate urgency and importance. Normally, the work of the CREED should be completed by the time, say, of the Board's summer recess. Given the formidable work load of the Executive Board in March and April, he wondered whether it would be wise to add another rather delicate issue to its agenda during the same period.

Mr. Kabbaj commented that the fact was that many Governors were concerned, at a time of such an unusual augmentation of the Fund's membership, about the possible risk to their representation; they were seeking assurance that a vote for the quota increase under the Ninth General Review and for the increase in membership would not be at their expense. He was not suggesting that the CREED should necessarily complete its work by the time of the Interim Committee meeting in April, but that it should be in a position to reaffirm that the existing broad geographical representation in the Executive Board would be preserved. Perhaps that principle could even be confirmed as part of the work of the Committee of the Whole on membership for the former republics of the U.S.S.R.

Mr. Torres stated that he supported the Managing Director's proposals. On a point of clarification, it would be helpful to know how the status of the exchange of letters and of the Special Association differed, and why use of the former offered more flexibility.

The General Counsel explained that there were a number of major differences stemming from the status of the former U.S.S.R. vis-à-vis the Fund and that of the republics. Previously, the Fund had been dealing with a federal government that had authority over 12 republics, and the Special Association agreement had contained a paragraph on the bilateral relations that could be established between the Fund and each of those republics. Currently, the Fund was dealing with up to 12 independent republics. As a result of the discussions that had taken place between the staff and the republics while they were under the authority of the Federal Government, it had become easier to assess their needs and to cooperate with them.

Two other elements of the Special Association with the Soviet Union did not appear to be necessary in the agreements with the republics, the General Counsel added. First, it did not seem necessary to specify that the republics would be invited to attend the 1993 Annual Meetings as special guests; the hope was that they would be members by that time. Likewise, it did not seem necessary to provide for the possibility of inviting representatives of the republics to attend the Executive Board's discussion on the world economic outlook; that was a matter the Executive Board could take up at the time of the discussion.

Apart from those differences, the General Counsel concluded, the framework of the agreements for the republics would follow that of the Special Association, as had the technical cooperation agreements that had been under negotiation with the republics before the dissolution of the Soviet Union.

Mr. Kafka said that he accepted the Managing Director's proposals. He was also in broad agreement with Mr. Kabbaj's proposal on the establishment of the CREED.

Mr. Végh said that he supported management's proposals. He also supported Mr. Kabbaj's proposal. It was very clear that the process of accession to membership for the republics of the former U.S.S.R. would be unusually short. Their membership, and that for Switzerland, would lead to a redistribution of voting power with broad consequences for the composition of the Executive Board. It was important, therefore, for national authorities to become aware of the implications before the Interim Committee meeting; for that purpose, the CREED should begin its work as soon as possible.

The Chairman remarked that the Swiss Government had to await the results of a national referendum before it could accept membership in the Fund. He recalled that a similar, earlier referendum on membership in the United Nations had not been successful. The CREED would, of course, have to bear the possibility of Swiss membership in mind in its deliberations.

Mr. Fridriksson stated that he, too, could agree to the proposals in the Managing Director's statement. He wished only to emphasize that the proposed rapid processing of the membership applications from Russia and the other republics of the Commonwealth of Independent States must not have the effect of slowing down the processing of the applications of the Baltic states.

On the timing of the CREED's work, Mr. Fridriksson said that he wondered whether some of the issues, which would not necessarily all have to be considered by the Committee, could not be considered in some other way, either formally or informally, in the two or three months ahead.

The Chairman responded that the guidance of the membership would have to be taken into consideration in determining how to meet the understandable concerns that were being expressed. He had taken note of the points that had been made, and he would revert to the issue with Executive Directors, possibly informally first and then in the appropriate formal way.

Mr. Peretz confirmed his agreement with both the proposals by the Managing Director. If it was at all possible in any way, including circulation of the relevant papers, he would support a further acceleration of the membership procedure.

Mr. Arora stated his support for the Managing Director's proposals on the membership issue and the Special Association agreements.

It was not clear to him whether the restructuring of the Executive Board was within the competence of the CREED, the election rules having been well established, Mr. Arora added. Of course, Mr. Kabbaj had raised an important issue, and the fundamental principles of broad geographic balance and the protection of the position of developing countries in the Executive Board would have to be kept in view.

Mr. Al-Jasser supported the Managing Director's pragmatic proposals for establishing a Committee of the Whole on membership for the republics and for taking up the methodology of quota calculations ahead of the review of the membership applications. It would be helpful to discuss the methodology issues before the applications for membership were taken up in order to ensure consistency and evenhandedness, given the impact of such a large number of countries joining the Fund at the same time.

He sympathized with Mr. Kabbaj, who had expressed the concern of some developing countries about their traditional representation on the Board, Mr. Al Jasser observed, although he did not fully share that concern, because the Managing Director's approach for meeting it seemed sensible. Certainly, the issue of geographic balance was in the mind of all members, who must give serious thought to the implications for the composition of the Board.

Mr. Clark confirmed his support for both of the Managing Director's proposals, which were pragmatic and would be expeditious.

Mr. Prader said that he supported the approach suggested by the Managing Director, in particular in respect of Fund membership for the republics. He had always suspected that the negotiation of the Special Association for the former Soviet Union might have been a factor delaying its membership. Care should be taken not to create two classes of centrally planned economies by treating later applicants differently from those whose quotas had been established in accordance with standard procedures.

He shared the concerns of other speakers about representation, Mr. Prader noted, and he supported their position.

Mr. Dawson said that he could agree with Mr. Prader's points on the need for preserving regional balance and equality of treatment among different kinds of planned economies. But he was by no means certain that the Board would have wanted to find itself in the position of membership for the Soviet Union prior to the country's dissolution on December 31, 1991.

Mr. Monyake considered that he perceived a sense of urgency about completing the membership process for the former republics of the U.S.S.R., contrary to the views expressed during the Board's discussion on the Special Association, which had focused on the difficulties standing in the way of membership. Apparently, the dissolution of the Soviet Union had eased such difficulties, whereas he would have thought that federal control should have facilitated the process of obtaining the information necessary for considering membership.

The Chairman remarked that whatever the constitutional regime had been, the Fund would have faced unknown, unique difficulties. He suggested that it be left to the Fund's historian to judge whether opportunities had been missed, either at Bretton Woods or more recently, although the surrounding events had never been in the Fund's control. Meanwhile, the Fund would respond to the best of its ability to the demands of the moment.

Mr. Landau said that he supported the Managing Director's proposals.

Mr. Finaish stated that he also supported the proposals. On the issue raised by Mr. Kabbaj, he shared his concern and that of many others.

Mr. Chen remarked that he, too, supported the Managing Director's proposals.

Mr. Arora commented that he understood Mr. Prader's point about the delay in proceeding with membership for the former Soviet Union. While he agreed with Mr. Peretz that the membership process should be expedited as much as possible, the really important issue was how to deal with the turn of events in the meantime. Conditions in the former republics were critical, and the institution should exert its moral authority to make available to Russia and the other republics the type of support they needed to carry on the process of reform. If the Fund was at risk of missing an opportunity, it was not so much in the sense of membership for the Soviet Union as such, but of not having started the whole process of membership and support sooner.

The Chairman noted that several Executive Directors had supported Mr. Kabbaj's views. He suggested that those Directors who wished to be members of the CREED should so inform the Secretary. The Committee could, of course, be established at an earlier date than usual, if there was a broad consensus to do so, but he suggested that an informal exchange of views on the matter should take place first to ensure that the process was a smooth one.

The Executive Board then took the following decisions:

Baltic States and Other Former Republics of the U.S.S.R. -
Committee of the Whole on Membership

The Board agrees to establish a Committee of the Whole, under the chairmanship of the Managing Director, to consider the applications for membership of the Baltic states and other former U.S.S.R. republics.

Adopted January 17, 1992

Former Republics of the U.S.S.R. - Cooperation

The Board approves the proposal by the Managing Director at EBM/92/4 (1/10/92) for cooperation with former U.S.S.R. republics for the period until the 1992 Annual Meetings.

Decision No. 9907-(92/6), adopted
January 17, 1992

2. ETHIOPIA - 1991 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1991 Article IV consultation with Ethiopia (SM/91/99, 5/16/91; and Sup. 1, 12/30/91). They also had before them a background paper on recent economic developments in Ethiopia (SM/91/122, 6/14/91; and Sup. 1, 1/8/92)

Mr. Monyake made the following statement:

The past several years witnessed some extremely adverse developments, the most important of which being the impact of the protracted civil war and the recurrent drought. Aside from these developments, the country had to grapple with a highly unfavorable external environment, which was reflected in depressed commodity prices, deteriorating terms of trade, and stagnating financial flows. The net result of these circumstances for Ethiopia has been large and mounting fiscal and external current account deficits. The new Government inherited such an economic situation when it took office in late May 1991.

In November 1991, the new administration announced a new economic policy framework, which is going to serve as a basis for pursuing economic and social objectives during the coming 2-2 1/2 years until an elected government is installed. The policy spells out a set of measures to be taken in different sectors of the economy, including agriculture, industry, energy, mining, construction, trade, and transport. It also maps out measures for the restructuring of the public enterprises and the reform of the tax system as well as the rationalization of public expenditure. The main thrust of the policy is the promotion of agriculture and the improvement in the efficiency of public enterprises, including privatization. Government policy is also geared toward encouraging foreign investment.

The private sector is to be allowed to play an increasing role in adjustment and development. It is also recognized that, given the overwhelming dominance of peasant agriculture, a significant rise in productivity should come from developing new technologies suitable to the individual peasant household and the provision of significant incentives to adapt improved technologies on the farms.

The authorities are aware of the need to strengthen the fiscal position. The budget proposal for 1991/92, which is now before the Council of Ministers, aims at significantly reducing the budget deficit from 15 percent of GDP in 1990/91 to about 9.6 percent of GDP in 1991/92. This is to be achieved mainly through cuts in current expenditure, thereby sharply curtailing the recourse to domestic bank financing.

Although the precarious external position continued to pose difficulties in the settlement of external obligations, the country had managed until recently to have an excellent debt repayment record, even when it meant cutting very essential imports at the expense of growth. However, for the first time in its prudent financial history, the country has slipped in recent months in servicing loans from official bilateral sources, particularly the former Soviet Union and Eastern European countries. In view of the continuing sharp decline of export earnings and foreign assistance, it was very difficult to avoid the accumulation of external arrears. The authorities regret this situation and intend to remain current, as far as possible, with obligations to all multilateral institutions.

It is the understanding of my authorities that much needs to be done to rebuild and further improve economic and social conditions. They are aware too that the successful achievement of these objectives depends heavily on securing adequate levels and the timely disbursement of external financial assistance.

In conclusion, I would like to convey my authorities' appreciation to the staff for the spirit of cooperation and understanding they showed during the consultations in Addis Ababa. They are now looking forward to the upcoming staff visit and wish to reiterate their commitments to the successful negotiation of the policy framework paper and arrangement under the structural adjustment facility (SAF).

Mrs. Krosby made the following statement:

We believe that these Article IV discussions with Ethiopia are a positive omen and a good start in themselves. With the end of the chaotic security situation, the authorities are now able to turn their attention to concentrating on the rehabilitation of the economy. It is clear, though, how far the authorities have yet to go, working as they do with a decimated economic infrastructure as well as with a lack of significant prior experience with market-oriented economic policies.

Against the backdrop of the current deteriorated economic situation, it is with some disappointment that we understand from the staff report that the authorities were intending to put off, at least for the remaining two years of the transitional government, key structural reforms. These include questions of ownership of land and financial institutions as well as the dismantling of the price control system, and--of particularly critical importance in this case--establishing a realistic exchange rate. The experience at the Fund to date indicates that the best reform avenue is to take as many of these structural measures as possible up front, sequenced appropriately with stabilization measures. We are encouraged, on the assumption that the authorities have understood the types of measures needed for a successful program under the SAF, to read from Mr. Monyake's statement that the authorities are committed to a successful negotiation of the structural adjustment arrangement. As daunting as this direction might seem to the authorities, we hope that they are soon convinced that it is fully in line with their broader goals for the economy.

Against the immediacy of the crisis in Ethiopia, it is disappointing that the authorities have taken long to finalize the budget for a fiscal year that is already half over. Given the paramount importance of fiscal policy in any potential program, and particularly in the case of Ethiopia, this would seem to indicate rather discouraging prospects. As to fiscal areas that need particular attention, we would encourage the authorities to focus on the expenditure rather than the revenue side. Revenues, although sharply down, are still not drastically low in relative terms. While the stabilization of revenues is important, it would largely take place indirectly through a recovery of growth and of trade, in part through adopting the appropriate exchange rate and reducing smuggling. It would seem critical for the authorities instead to focus their attention on cutting expenditures, notwithstanding the decrease in military expenditures that has already taken place. Further discrete and lasting cuts in the very high level of wages as a percent of current expenditures and the opaque "materials" category, along with the phasing out of subsidies and grants, would seem to be warranted.

Of course, ultimately--because there is no doubt that the current level of monetization of the deficit is unsustainable, and given the absence of other means to finance the deficit domestically in a noninflationary manner--that points unavoidably to a sharply smaller deficit in the near future if the authorities are to stabilize the economy.

A complementary policy on the financial side of the economy would involve immediate moves to raise interest rates to positive levels in order to suppress credit demand and a more systemic improvement in the interest rate structure in the medium term.

We are very pleased to see the authorities emphasize the private sector in their goals for economic adjustment, particularly through reoriented policies for restructuring and privatizing public enterprises as well as for encouraging foreign investment. With regard to the former, we look forward to a timetable in future program documents, spelling out detailed actions on public enterprise reform. With regard to the latter, a defined legal structure on private ownership will be important to promote foreign investment. Additionally, it is clear that overall confidence in the economy always plays a key role in attracting foreign investment, something that a broad but well-defined economic stabilization program would do much to support.

Mr. Dognin made the following statement:

Major changes in the political landscape have occurred in Ethiopia since the last Board discussion in 1990. A new transitional government was established in August 1991 pending elections and a referendum on the secession of Eritrea to take place within the next two years. This chair welcomes this process which will hopefully bring an end to a 17-year state of war. However, the new opportunities on the economic front created by this political evolution are still hampered by severe fiscal and external imbalances. The deterioration of the terms of trade and the shortages of foreign currencies have severely limited output and trade, resulting in a decline of 5 percent of GDP in 1990/91, and a substantial increase in the current account deficit to the level of 7.2 percent of GDP.

Although the draft Economic Policy Paper designed by the transitional government is a welcome step in the right direction, key structural reforms and a comprehensive macroeconomic program are to be contemplated to reverse the economic deterioration. In this context, while not underestimating the difficulties of such a transitional period, I encourage the authorities to embark without further delay on a more extensive process of reform that will pave the way for financial support from the international community commensurate with the task of rebuilding the economy.

Let me now comment on the following four issues:

First, a policy of fiscal retrenchment should be at the core of the authorities' strategy to bring the budget deficit back to a sustainable level. In this regard, the sizable reduction in the budget deficit expected for 1991/92, as indicated by Mr. Monyake in his statement, is encouraging. However, like Mrs. Krosby, I think it is urgent to expedite the adoption of the 1991/92 budget.

On the revenue side, the main challenge is to reverse the decline in revenue. This will not be an easy task given the present recession in output and trade, and it will require, as rightly indicated by the staff, an overall revision of the tax base, taking into account the new sales tax and the necessary customs tariffs reform. The assistance that is to be provided by the Fund in this matter is certainly welcome.

On the expenditure side, significant cutoffs in military outlays contributed largely to bringing overall expenditures from 43 percent of GDP in 1989/90 down to 31 percent in 1991/92. However, it is worth noting that although further reductions in current expenditures might be achieved, reconstruction of the economic and social infrastructures will require substantial additional resources. Therefore, the authorities should strive to achieve a better allocation of resources for priority spending in the transportation, education, and health sectors. Additional expenditures will also be necessary for the resettlement of dislocated populations. The planned review of public expenditures with the assistance of the World Bank will certainly be instrumental in helping the authorities to design new priorities for the budget.

Second, the persistence of large fiscal imbalances clearly hinders the handling of monetary policy, as most of the budget deficit is being financed through the domestic banking system. Given the limited availability of nonbank resources, the authorities have little choice but to curtail the deficit to reduce the existing monetary overhang and consequential pressures on prices and the exchange rate.

Concerning interest rates, and given the level of inflation, there is an urgent need to re-establish positive real interest rates. The present situation leads indeed to many distortions in resource allocation that discriminate against the private sector in particular. Owing to the importance of creating a more market-based financial sector, I would appreciate some comments from the staff on the progress made in the discussions with the authorities toward a comprehensive restructuring of the financial sector.

Third, the most commendable and decisive structural measures that have been undertaken so far by the authorities deal with the agricultural sector. As a matter of fact, the privatization of farming and the liberalization of prices and marketing had the expected favorable effect on agricultural output, which still accounts in Ethiopia for 4 percent of GDP. Moreover, the special decree on investments promulgated in May 1990 gave a new impetus to private investment in other sectors. Nevertheless, measures aimed at liberalizing the economy clearly need to be enhanced. In this regard, the authorities should take further steps in three main directions: first, to adopt new land tenure legislation; second, to design and implement a comprehensive restructuring of the public enterprise sector, especially in the transportation and manufacturing sectors; third, to deregulate prices; remaining price controls, in addition to the overvaluation of the exchange rate, still generate trade distortions and encourage smuggling with neighboring countries.

Fourth, and finally, turning to the external sector, the situation is expected to deteriorate further in 1991/92 with a sharp decline in exports. Moreover, a projected widening of the overall balance of payments deficit would, in the absence of foreign financial assistance, lead to the further accumulation of external arrears, which could reach the unsustainable level of SDR 530 million by mid-1992.

The diagnosis of corrective measures has been clearly identified in the staff report, and I broadly share its recommendations. I would therefore make only two remarks: first, it is indeed urgent to remove the bottlenecks, mainly the availability of transportation and imports, that still constrain output in the main export-oriented sector; and second, the emphasis placed by the authorities in the reform process on priority measures to remove these bottlenecks in the economy is indeed justified under the present circumstances, and the financial assistance of the World Bank in the form of an emergency credit is certainly welcome. However, this financing should not be regarded as an alternative to a comprehensive macroeconomic and structural adjustment program.

Furthermore, the level of financial imbalances and the wide range of structural measures to be implemented in the coming years require strong support, both technical and financial, from the international community. I therefore encourage the authorities not to defer the reforms that will lay the groundwork for a possible Fund-supported program and will help to normalize their relations with creditors. As rightly noted by the staff, it is also crucial that the nature of the economic links between Ethiopia and Eritrea be clarified.

To conclude, this chair welcomes the thrust of the authorities' Economic Policy Paper but encourages the transitional government to take advantage of the international support created by the recent political process in Ethiopia to gain momentum in the reform process. I wish the authorities well in their endeavors.

The staff representative from the African Department said that although a slow start had been made in terms of putting together the Economic Policy Paper, and also in terms of building up a consensus for the program, the process had advanced, and a number of its aspects had been discussed by the mission. On the budgetary position, which had deteriorated sharply in the past two years, the major problem, particularly on the revenue side, was the socialized tax system under which a substantial share of revenue came from the public enterprises. The shortage of foreign exchange and the decline in the activities of the public enterprises had led to a sharp drop in revenue. The private sector had also made an inadequate contribution to revenue. Therefore, in order just to stabilize revenue at its current level of about 18 percent of GDP, the Ethiopian authorities would need assistance in developing a new tax structure. That assistance had been requested from the Fund, and was expected to be provided.

On the expenditure side, immediately after the cessation of the hostilities of the civil war, military expenditure had fallen sharply, as the data for 1991 showed, and should fall further during the current year, the staff representative continued. Therefore, expenditures would decline, although part of the slack might be taken up by the need to increase expenditure on social programs, which had been neglected during the civil war, to the point at which some barely existed. Hopefully, Ethiopia would receive assistance from external sources in restoring those programs.

Public sector restructuring posed a difficult problem, and the solution would call for initiative and strong will on the part of the authorities themselves, the staff representative observed. An initial start had been made in that direction in the form of a recognition by the authorities that they needed to move strongly in the direction of privatizing as well as rehabilitating the existing structure. However, given the circumstances of the past year, little progress had been made, although the authorities intended to take steps, to what extent and how vigorously remained to be seen; but in future contacts with the authorities, the staff would discuss the issue thoroughly.

The high level of inflation reflected in the data for 1991 was partly scarcity driven, the staff representative explained. The consumer price index covered only Addis Ababa, and for a while during the year, access to the city had been closed. The resulting shortages had driven up price levels in Addis Ababa, particularly in May and June, and shortages were still occurring because of transportation difficulties. Nonetheless, a substantial amount of the inflation was explained by the financing of the budget deficit and the monetary expansion. The sharp increase in inflation in the past two years, and the rather rigid interest rate structure, had led to negative interest rates, even though historically Ethiopia had maintained positive real rates. The negative interest rates would call for attention in whatever comprehensive program the authorities might want to adopt.

The possibility of an arrangement under the structural adjustment facility had been discussed with the authorities, and a timetable on how to proceed had been delineated, the staff representative from the African Department noted. The authorities' intention was to use their own Economic Policy Paper, which had been under consideration during the mission's stay, as a basis for discussions on a policy framework paper. The Economic Policy Paper had since been adopted by the parliament, but it was a very general document, containing few specifics and, as yet, no timetable of policy implementation. Nonetheless, the authorities had asked for a staff mission to return in early 1992 in order to start the process.

Mr. Fernando, referring to the apparent expectation of a possible improvement in the fiscal situation arising from a reduction of tensions and hostilities, remarked that while the curtailment of expenditures of a military nature hopefully would ease that situation, estimates of the likely outcome should be made conservatively, for two reasons. First, account would have to be taken of the composition of military expenditure; if the wage component was high, it would be illusory to count on substantial savings, even if the conflict was resolved. Second, even if the conflict did end, there were likely to be reconstruction expenditures, which would also need to be taken into account in estimating the size of any likely positive impact on the budget of reduced military spending.

Mr. Martínez-Alas made the following statement:

> Reviewing countries with a disappointing economic performance aggravated by political unrest is, paradoxically, both sad and hopeful. Sad because a deteriorating economic situation is more than ups and downs in a GDP ratio; it means that opportunities for human beings to enjoy a decent standard of living are forgone, sometimes forever. Nonetheless, it is hopeful because we witness a strong commitment to correct misguided policies and to reorient societies toward market-based economic frameworks and the rule of law.
>
> Although the ongoing transformation of Eastern Europe and the former Soviet Union is the event of the century, because of all its implications for the world economy at large, we should not forget that several third world countries were also embarked on failed central planning experiments and they, too, want to get rid of that legacy. The international financial community should bear in mind that such a task requires large amounts of technical and financial assistance.

We welcome the actions already taken by the Ethiopian authorities to transform their centrally planned economy into a market-oriented economy and to implement major structural measures. Especially welcome is the legislation related to property rights, such as decrees on land ownership and the restoration of the commercial code. The successful transition to a market-oriented economy will rest on a clearly defined and enforceable property rights scheme that allows individuals to carry out voluntary contractual transactions.

We are also pleased to learn from Mr. Monyake's statement that the budget proposal for 1991/92 has been completed and that it aims at an important budget deficit reduction. This tight fiscal policy stance speaks well of the authorities' intentions to work under a sound policy framework. However, regarding economic policy measures in general, we share the concerns already expressed by previous speakers.

Finally, in view of the rapidly deteriorating situation of the Ethiopian economy, we urge the authorities to act quickly and without delay to implement a wide-ranging, comprehensive structural adjustment program that could be supported by the international financial community.

Mr. Shimizu made the following statement:

At the outset, I would like to express my strong hope that the May 1991 ceasefire will definitely bring Ethiopia's economic situation back to normal, even if it takes time.

Ethiopia has been facing profound economic difficulties, as evidenced by the high rate of inflation, declining output, and the adverse balance of payments position, owing to the long civil war and infrastructural bottlenecks. Underlying factors include the weak financial policy, resulting from the large fiscal deficit, and large price distortions. However, the ceasefire has given the authorities an opportunity to reverse the declining trend of the economy by means of a comprehensive adjustment policy. I would attach particular importance to reducing the fiscal deficit and reducing the widespread price distortions. In this connection, like Mr. Dognin, I welcome the fact that the authorities have prepared an Economic Policy Paper, which could be the basis for a future Fund-supported program.

The fiscal deficit is large--about 15 percent of GDP in 1990/91--and bank financing of the deficit has contributed to the expansion of credit and, hence, to the high rate of inflation. In particular, it is worrisome that tax revenue has declined sharply since 1987/88 by some 13 percent of GDP; this declining trend should be reversed. In this connection, it is welcome that Fund technical assistance will be provided to restore the tax base.

Widespread price distortions are reducing the efficient allocation of resources by sending the wrong signals to the economy. The overvaluation of the birr by more than three times the market rate has reduced the competitiveness of exports, as well as encouraged smuggling. The interest rate is negative in real terms and thus is fueling credit expansion. The extensive price controls are reducing producer incentives. Establishment of an adequate price structure should be given the highest priority.

In conclusion, the authorities should fully utilize the opportunity provided by the ceasefire to restore the economy by implementing a comprehensive adjustment policy that would include reducing the fiscal deficit and price distortions. In the face of such profound difficulties, the gradual approach favored by the authorities will not work. As the staff recommends, only up-front policy actions will improve the difficult economic situation. With these comments, I wish the authorities well.

Mr. Solheim stated that the end of the large-scale military conflict was welcome news indeed, but it was painfully clear from the staff's supplementary report that Ethiopia--with its exceptionally low income levels and difficult social conditions--was facing severe hardships. In view of the magnitude of the problems of the Ethiopian economy, and the rapid deterioration of the economic situation, prompt action by the authorities was called for.

As he was in full agreement with the staff appraisal, which in a very appropriate manner was stressing the urgent need for policy dialogue and for building up a comprehensive economic adjustment program, he would make only a few comments concerning the future stance of economic policy, Mr. Solheim continued. The staff urged the authorities to move promptly with up-front macroeconomic measures, to comprise both restructuring and implementation of strong fiscal and monetary measures, including exchange rate action. With Ethiopia's already weak external competitiveness projected to deteriorate further--virtually all export products were said to require government subsidies to break even--there appeared to be an immediate need for action, which, inter alia, could contribute to improved competitiveness and reduced smuggling. Consequently, he failed to understand the authorities' hesitation to correct the substantial overvaluation of the official exchange rate due to social concerns. The independent measures taken by Eritrea and Ethiopia--for example, in the foreign exchange and banking fields--could easily worsen the immediate economic prospects of both and should be decided in close policy coordination.

In conclusion, even if Ethiopia should receive increased donor support, that alone would not be enough to jump start the economy, Mr. Solheim said. The authorities must therefore press ahead with comprehensive policy measures addressing the serious state of the country.

Mr. Koissy said that it was clear from the staff papers that Ethiopia, which was emerging from a long period of social unrest and military conflict, was facing very difficult economic prospects. The extremely low level of per capita income, the drought conditions, and the protracted armed conflict that had plagued the country were all factors inhibiting economic development and growth. As such, the authorities' task ahead would not be an easy one and would call for strong determination. It was therefore encouraging to note that the transitional government had moved quickly to develop a new economic policy framework aimed at providing the basis for managing the economy during the interim period. He joined previous speakers in commending the authorities for undertaking such a program of economic and financial reform and would encourage them to persevere in their efforts to create an environment conducive to productive economic activity.

Overall, his chair was in broad agreement with the staff's analysis and appraisal, Mr. Koissy continued. He shared their view that the reforms should be undertaken in the framework of a comprehensive program of structural adjustment. While agreeing that several measures should be speedily implemented, especially in the fiscal and external sectors, he agreed with the authorities' cautious approach to structural reforms, the more so since the appropriate supporting legal and other institutional frameworks were yet to be put in place. That point pertained especially to land reform and property rights issues, which took time to deal with. Moreover, in view of the large influx of refugees, it was also understandable that the reform of the public enterprises and the civil service should proceed in a gradual way so as not to add to the chronic unemployment situation. In that respect, the provision of appropriate social safety nets in the initial stages of the reform would be critical to the success of the adjustment process. Donor support was of paramount importance, not only to help deal with the cost of the immense social displacements brought about by the civil war, but also to rebuild the country's infrastructure and to support the economic reforms.

In that respect, his chair had been pleased to learn that the World Bank and other bilateral donors were prepared to provide quick-disbursing financial assistance to ease the shortage of imported inputs and parts, Mr. Koissy remarked. He asked whether the staff had made any preliminary estimate of the magnitude of financial assistance that Ethiopia would need to implement its reform program successfully.

Mr. Al-Tuwaijri made the following statement:

> Ethiopia is an extremely poor country which can ill afford the rapid economic decline that has resulted from the cumulative impact of past adverse developments and inappropriate policies.

Therefore, it is essential that the authorities exert every effort to redirect the economy onto a positive course. At the heart of this effort must lie a transformation of the economy away from centrally administered controls toward greater reliance on market-based signals. Furthermore, such a restructuring will need to be underpinned by the restoration of a stable domestic financial environment. It is encouraging to note from Mr. Monyake's statement that the authorities recognize the merits of such a policy approach. But there is also a need for decisive action to set the economy firmly on the path of adjustment and growth.

I agree with the thrust of the staff's two appraisals and have some selective comments. In particular, I would emphasize the importance of introducing as much certainty as possible into the recovery process. Thus, while since early 1990 the relaxation of some controls is welcome, more remains to be done. For example, the partial withdrawal of government controls on consumer and producer prices and the more general de facto liberalization of prices already have yielded a positive supply response. However, a firm official espousal of price liberalization by the authorities would yield greater benefits by solidifying the role of markets in determining relative prices. Such an action would increase the confidence with which private agents could make production and investment decisions. Also, incentives to invest productively in the agricultural sector are likely to be weakened by continued uncertainty over land ownership.

These examples illustrate the need for, and potential rewards of, implementing reforms sooner rather than later, especially in areas such as land tenure, where experience elsewhere has shown that the pace of progress is typically slow. At the same time, I recognize the difficult social and political situation in which the authorities are operating. However, it is often the most sensitive issues that are the most critical, and I would encourage the authorities to actively build a consensus for structural reform rather than delay crucial actions until the next elections.

Clearly, the early restoration of domestic financial stability will be critical, and on this issue I concur with the several policy recommendations of the staff. The fiscal situation is particularly difficult, because the authorities are faced with a small and declining revenue base as well as considerable pressures for spending to ease transportation bottlenecks and alleviate national hardship. In these circumstances, I would encourage the Government to press ahead with its initiatives to divest public enterprises, which could provide a useful and quick, albeit temporary, source of revenues. Such revenues could help contain bank financing of the budget while permanent revenue and expenditure reforms are being put in place. These sales also would help absorb part of the monetary overhang that has recently built up. Of course, more fundamentally, the divestiture and the restructuring of the large public enterprise sector are key to the authorities' aim to transform the economy into a market-oriented system.

As regards the exchange rate, much would be gained from a substantial realignment, together with an extensive liberalization of the highly restrictive exchange and payments system. A number of factors will need to be taken into account in deciding upon the magnitude of the devaluation, including the present low level of reserves, the size of the monetary overhang, and the strength of financial policies. I wonder how the staff view this question. The scarcity of foreign exchange and growth of smuggling, among other things, call for timely action in this area. Such action would not only improve producer incentives in the private sector, whose vitality already is evidenced by the growth of parallel markets, but also would reintegrate informal markets into the formal sector of the economy, thereby helping to rebuild the revenue base of the Government.

The challenges facing the authorities are great and call for an effort of commensurate strength, as well as the support of the international community. I wish the authorities well.

Mr. Kabbaj remarked that economic conditions in Ethiopia continued to be characterized by serious difficulties, and the medium-term prospects were highly uncertain. That situation resulted from the prolonged civil war and inappropriate policies in the past that were being reflected in the persistence of large fiscal and current account deficits, the accumulation of external payment arrears, and an overall economic decline.

The staff had outlined the measures that needed to be implemented in order to redress the serious economic problems and to tackle, in particular, the overrun in current expenditures and in domestic bank financing, Mr. Kabbaj added. While he was encouraged by the authorities' awareness of the need to bring both domestic and external imbalances to sustainable levels, his chair considered that, in view of the widespread economic difficulties and the country's high dependence on concessional aid, the authorities should strengthen their policies and, in collaboration with the Fund and the World Bank, rapidly develop a sound fiscal and monetary program and comprehensive structural reforms that could be supported by exceptional financing from the donor community.

Mr. Végh commented that he had some difficulty accepting the remark made by the staff representative on scarcity inflation. Inflation was a monetary phenomenon. If Ethiopia had a barter economy, there would be no inflation at all at the same level of scarcity. That held true also for the former republics of the Soviet Union. If the republics adopted a key international currency as their own currency, as they should do, in his opinion, and as the European Community was doing to a certain extent, they would have no inflation. In sum, the real phenomena had to be separated from the monetary phenomena.

The staff representative from the African Department noted that in 1990, grain prices had been formally liberalized, while other prices were also de facto liberalized, under the policy of the Government at the time of not enforcing price controls, with only a few exceptions, such as pharmaceuticals and medicines, remaining under price control. Nonetheless, enterprises had been used to administered prices for so long that there was still an element of rigidity, particularly in those enterprises that were the sole producers of certain products. Recently, the divergence between wholesale prices and retail prices had increased greatly, as retail trade moved increasingly into the private sector. The staff had impressed upon the authorities that they should not only not enforce those price controls that were on the books, but completely abolish them.

The authorities had made progress toward completing the budget since the staff mission, and they had a budget that was close to what had been expected, the staff representative said. But to go beyond that initial step to a program should be possible in the budget for the following year, starting July 1992; that budget was important because it could reflect elements of most of the staff recommendations and whatever appropriate policy action that might have been taken in the meantime.

The composition of past expenditure was such that most had been for military purposes and for capital projects, the staff representative added. However, capital expenditures had been cut down quite drastically over the years, to give way to increases in military expenditure. Capital outlays, together with military expenditure, would be cut further in the current year. Wages had been frozen for a very long time, but with very high rates of inflation, pressure to increase wages was building up, as it was to increase social services, which also had been held back. As Executive Directors had indicated, there would be a need for postwar reconstruction, which even if funded from abroad, would require local counterpart funds to implement the reconstruction projects; to that extent, those components of expenditure should be expected to rise.

The resources needed to rehabilitate the economy would definitely be large, the staff representative from the African Department stated, and the extent of generosity of the international community would determine the pace of recovery for Ethiopia. Of course, the Ethiopian authorities could do a great deal themselves to mobilize the country's own resources by vigorously implementing the major appropriate measures up front, especially on the exchange rate; significant resources were being lost across the borders through smuggling. At the time of the mission, the authorities were putting together their own ideas on a possible program, and they had not been in a position to discuss with the mission a detailed medium-term scenario. One essential accompaniment to a possible program would be relief of Ethiopia's large debt burden. A few countries had canceled debt bilaterally, and the Ethiopian authorities hoped that other donors would take similar action.

Mr. Monyake thanked Executive Directors for the encouragement they had given to the Ethiopian authorities, and for their appreciation of both the prior and current situation. In that context, Directors should note that hostilities continued in some areas in Ethiopia, despite the talk about their cessation. Thus, military expenditure might not be reduced to the extent expected or to the extent that it should be. Consequently, programs and projects that otherwise would be undertaken in a more peaceful situation might not be undertaken as quickly as they ought to be. The authorities still faced problems in re-establishing full stability. Furthermore, it was premature to talk about cooperation between Eritrea and Ethiopia until the issue of whether the two would remain one nation or whether Eritrea would become a separate nation had been settled.

It was unfortunate that key structural reforms had had to be postponed, as the authorities themselves agreed, Mr. Monyake stated. But in the unfortunate situation that he had described, they were limited to attempts to tackle problems as soon as the opportunity presented itself. It also needed to be kept in mind that many developing counties did not have the benefit of a civil service that could keep the country running in the absence of a government; rather, the civil service was inclined to be highly politicized, and a change of administration threatened the continuity and stability of the civil service itself. For instance, drawing up a budget was an exercise that took a whole year; it was not a matter of a few months, and any administration that tried to compress the exercise ended up by finishing it late. The administration in Ethiopia had been in place for only a few months, and it had not been easy for it to finalize the budget exercise in the proper time, although it was doing its best.

Another general issue that was relevant concerned land tenure, Mr. Monyake commented. In many developing countries, especially in Africa, the preferred form of land tenure was the traditional one, which had worked so far and to no-one's disadvantage. When most of the population was rural peasantry, the result of introducing a land tenure system that opened up land ownership to everyone was more likely to be the emergence of a large landless class, and high unemployment, without a social safety net. The traditional land tenure system in developing countries in effect was a form of social security; if people had rightful access to a parcel of land, they could not make the claim to the government that they had no employment or means of sustenance. If that system was changed, other systems would have to be changed as well, particularly to provide a livelihood for the landless. The social implications of tinkering with the land tenure system thus had to be taken into account.

The Chairman made the following summing up:

Executive Directors were in agreement with the general thrust of the staff appraisal. They noted that the new Government inherited an economy which has suffered a marked deterioration, mainly as a result of inappropriate policies pursued over the years and the diversion of resources to military purposes, exacerbated by the effects of recurrent droughts and an adverse turn in the terms of trade. In recent years, the economy has experienced a decline in real GDP, an acceleration in the inflation rate, a serious deterioration in the fiscal position, and severe balance of payments pressures, accompanied by the emergence of external payments arrears.

Directors noted that the end of the civil war provided an opportunity for the authorities to address comprehensively Ethiopia's economic problems. Priority should be attached to the dismantling of the pervasive controls over economic activity and the removal of distortions in resource allocation with a view to introducing market-oriented policies that would permit private initiative to flourish. In that regard, the early clarification of property rights issues through appropriate legislation was regarded as essential by Directors.

Directors noted also the new economic policy paper that had been adopted recently by the new Government, including the emphasis given to the promotion of agriculture, the encouragement of foreign investment, and the reform and rationalization of public enterprises, including privatization. Directors also noted the budget proposals for 1991/92, which aim at significantly reducing the budget deficit from 15 percent of GDP in 1990/91 to less than 10 percent. Fiscal policy should focus on restraining current outlays, and on the reorientation of outlays toward the rehabilitation of infrastructure and other priority sectors such as education and essential social services. Directors stressed that credit and monetary expansion will need to be tightly restrained, interest rates should be adjusted to positive levels in real terms, and a realistic exchange rate should be adopted as soon as possible. At the same time, fundamental reforms are needed in the public enterprise sector, including the privatization and liquidation of loss-making entities. In the process, the employment and wage structure of the public sector should be reviewed, to reduce the number of redundant employees and rationalize the wage structure.

Directors viewed favorably the complementary role of the World Bank's quick-disbursing emergency credit in easing transportation bottlenecks, repairing essential infrastructure, and providing imported inputs to jump start the economy. Directors stressed the need for close economic policy coordination with the Eritrean administration.

In conclusion, Directors expressed the hope that the Ethiopian authorities would soon be able--with staff assistance from the Fund and Bank--to put together a coherent policy framework paper and to start implementing a policy package that would attract external assistance, including Fund support.

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

3. REPUBLIC OF CONGO - 1991 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1991 Article IV consultation with the Republic of Congo (SM/91/251, 12/26/91). They also had before them background information in the form of a statistical annex (SM/91/254, 12/30/91).

Mr. Santos made the following statement:

From the outset, it should be recalled that the 1991 Article IV consultation discussions with my Congolese authorities took place shortly after a lengthy period of social upheaval and political tensions which led to the convening of a National Conference and the election of a Prime Minister in June 1991 to oversee the transition toward a multiparty democracy. Soon after its inauguration, the transitional government began assessing the economic and financial situation of the country to determine the magnitude of the adjustment efforts required to reform the economy. My authorities' evaluation of the situation is not different from that of the staff. They concur with the staff that their country emerged from this political process with severe economic and financial difficulties which have set back the country's initial progress in reforming the economy. I shall, therefore, limit my statement to highlighting some recent economic and financial developments and the main elements of my authorities' plan of action.

Following the reform measures implemented by the authorities in early 1990, and supported by a 21-month stand-by arrangement from the Fund, substantial progress was achieved on many fronts. There was a sharp shift in the primary fiscal position, from a deficit over the previous four years averaging 5.3 percent of GDP, to a surplus equivalent to 2.4 percent of GDP in 1990. The overall fiscal deficit, on a commitment basis and excluding grants, was also sharply curtailed. Monetary policy was tighter than programmed and inflation declined much more than envisaged.

The trade balance recovered to its pre-1986 level, thus contributing to a much better than programmed external current account position. The improvement in the external current account more than offset the impact of a slower than programmed inflow of external resources, resulting also in an improved overall balance of payments position. Furthermore, Paris Club creditors accorded debt relief, which laid the ground for the normalization of Congo's financial relations with its bilateral creditors.

These favorable developments were brought abruptly to a halt as political and social unrest prompted the authorities to make wage and employment concessions and to reverse a number of policy measures implemented under the program supported by the Fund and the Bank. While the National Conference helped to resolve the political crisis and enabled the election of a Prime Minister to head a transitional government until June 1992, it did not give a clear mandate to reverse the policy decisions of the previous government.

Economic and financial developments in 1991 therefore reflect these constraints, the uncertainties associated with the political situation, as well as the large terms of trade losses incurred in 1991.

In the real sector, with the disruption of virtually all non-oil economic activities in early 1991, real GDP growth is estimated to have fallen short of the programmed level. Preliminary fiscal estimates for 1991, based on the outcome for the first seven months, indicate that budgetary revenue is likely to decline by about 12 percent while total expenditure and net lending are estimated to increase by about 9 percent, resulting in a shift of the primary fiscal balance to a deficit of about 9 percent of GDP in 1991. In the external sector, with oil export revenue contracting sharply, the deficits on both the external current account and the overall balance of payments are estimated to have reached unsustainable levels.

It is in this context that the transitional government has prepared a draft plan of action aimed at restoring the conditions for the resumption of the adjustment process and addressing the most urgent economic and financial problems confronting the country. The authorities recognize, however, that the speed of the adjustment process could be constrained by the social and political situation and the limited mandate of the transitional government, as well as by the lack of adequate social safety nets. They are nevertheless determined to implement those urgent measures that are necessary to arrest the deterioration of the economic and financial situation. To this end, a number of measures have been taken. In the fiscal sector, these include measures aimed at improving the efficiency of the financial administration and ensuring accountability in management of public resources. In this context, the treasury's statutory control over public resources is being restored. As a first step, all special accounts have been consolidated under a single management, and a number of measures have already been put in place to facilitate treasury liquidity management. Tax assessment and collection procedures are also being streamlined to reduce fraud and evasion. In addition, the authorities are currently reviewing various aspects of their subregional common customs and economic union (UDEAC) with a view to reducing most of the constraining elements of this system on the members' fiscal management. Moreover, the authorities are reinforcing the measures aimed at improving transparency in the oil sector, which should result in a greater contribution by this sector to government revenues. On the expenditure side, the rigid system of transfers and subsidies to public enterprises is being reviewed. It is also the authorities' firm intention to address the issue of staffing in the civil service.

In the context of their monetary arrangement, my authorities have made substantial progress in modernizing and simplifying their monetary policy instruments. In this regard, procedures for the determination of interest rate policy have been streamlined and the preferential discount rates have been tightened considerably. Moreover, the rehabilitation of the financial sector is well under way, with proposals to reduce government participation in the banking sector and mobilize resources for the rehabilitation of this sector. Parallel to these measures, the authorities intend to strengthen bank supervision and control as well as adopt international standards for establishing banks' prudential ratios. To this end, a regional banking commission will be set up shortly.

In the external sector, the authorities have recently initiated further liberalization of the trade and licensing system so as to reduce public enterprises' monopolies and promote private sector participation. Moreover, a comprehensive reform of the external tariff of UDEAC is under way with the assistance of the Bank and the Fund. My authorities are mindful of the impact that the rigidities in the labor market and the infrastructural bottlenecks could have on the competitiveness of the Congolese economy and on their efforts at economic diversification. A set of structural measures aimed at addressing these issues is contemplated in the plan of action.

In conclusion, my authorities are fully aware that the corrective steps taken to address the economic and financial difficulties confronting the Congo will have to be supplemented by additional measures along the lines of those previously agreed with the Fund and the Bank. It has to be recognized however, that given the deterioration of the economic situation, these measures will entail hardship for a large segment of the population. My authorities are of the view that, in order to ensure the broadest possible support for the adjustment process, the envisaged measures will need to be well timed and appropriate social safety nets will need to be in place. They are hopeful that the outcome of the second phase of the political process under way should facilitate the resumption of a comprehensive adjustment program that can be supported by the international financial community.

Mr. Martínez-Alas made the following statement:

The Republic of Congo's economic performance during the period covered by the consultation is disappointing, and future prospects for improvement look bleak. Political and social unrest, serious policy slippages, mainly in the fiscal sector, and the reversal of important structural measures worsened the impact of external shocks related to falling international oil prices. The Congolese authorities face a very difficult twofold task: to provide a social safety net and to restrain public expenditures.

The compelling need for bold, up-front, and quick policy actions and structural measures is highlighted by the statistical data on the structure of GDP and estimated growth, the balance of payments outlook, and the burden of debt service and increasing external arrears. We will concentrate our statement on the excessive weight of the public sector in the Congolese economy, the inadequacy of financing through arrears, and the necessity of resuming the implementation of structural measures if the economy is to be put back on the right track.

The public sector's overburdening of the economy is exemplified by the following indicators: public consumption accounts for over a quarter of GDP; a 15 percent annual change in public consumption explains the estimated 2.2 annual percent change in real GDP growth for 1991, once the decrease in all other sectors is taken into account; and public sector employment represents almost 50 percent of total salaried employment. The aforementioned situation poses an undue pressure on the prospects for future recovery. In this regard, we share the staff's opinion "that the chances for restoring growth in an environment of stability would be seriously in doubt without an early implementation of wide-ranging public sector reform."

For 1991, the balance of payments was financed, up to 70 percent, by the accumulation of arrears. This method of financing implies external payments restrictions, which means noncompliance with the Fund's Articles, highlights the structural weakness of the external sector, and recalls, once again, the need for a more realistic approach toward debt reduction for poor countries. We urge the authorities to clear their arrears with the international financial community, and we advise them to avoid recourse to this type of financing in the future .

In addition to the public sector reform already mentioned, the authorities need to move more rapidly on financial sector reform, addressing labor market rigidities and privatization. In this respect, we would like to echo the staff's opinion that "the implementation of credible structural reform...would require considerable external assistance, both technical and financial," and to remind the international financial community that more recent, and valid, concerns should not overshadow the acute technical and financial needs of third world countries in Africa and in Latin America.

Finally, we would like to express our satisfaction with respect to the authorities' plan of action, explained by Mr. Santos in his statement, which comprises measures in the fiscal sector, monetary arrangements, financial markets, the external sector, and also structural measures. The plan of action is comprehensive and oriented in the right direction, since better fiscal administration and tax collection, modern monetary instruments, sound prudential regulation, and trade liberalization will contribute to the resumption of the adjustment process, unfortunately on hold owing to social and political circumstances. Although we are fully aware of the political constraints faced by the Congolese authorities, a bold and quick undertaking is more advisable by far than a gradualist approach to stabilization.

Mrs. Martel made the following statement:

Since the last Board discussion on the Congo in August 1990 (EBM/90/137, 8/27/90), the situation has changed greatly. First, the political reforms have led to the emergence of a democratic process, which this chair welcomes; and second, the economic situation has deteriorated, as the staff report makes clear. The transitional government has drafted an action plan, the thrust of which this chair approves. While being aware of the social and political situation, this chair is also of the view that such a plan needs to be supported by some operational measures.

With these considerations in mind, I intend to concentrate my remarks on four specific points.

First, the staff's report underlines that fiscal measures are the cornerstone of the actions to be taken by the authorities. The very helpful projections made by the staff in the annex to the staff report, especially Table I, show that no significant improvements in the primary balance can be expected before 1993, even in the context of the adjustment scenario. Therefore, further strengthening of fiscal measures must be considered, and I fully agree with the staff that front-loaded action is necessary beginning with the 1992 budget.

On the revenue side, while we welcome the authorities' intention to launch an audit to achieve more transparency in the oil sector, the authorities' thrust on this matter is somewhat misleading and gives the impression that reforms in the oil sector could be an alternative to a more stringent stance in fiscal management.

More specifically, the assumption of a significant increase of CFAF 20 billion a year in oil revenues as of 1992, owing to the audit, seems to be somewhat optimistic. We would appreciate some comments from the staff on this issue as well as some indications on the projected level of oil output for the medium term.

The most urgently needed revenue measure of all is certainly the reintroduction of the domestic tax on petroleum consumption. It is also essential to design in a timely manner comprehensive programs aimed at strengthening customs and tax administration.

On the expenditure side, the restrictive stance proposed in the action plan is much welcome, especially the government staff cuts. Prompt action is also necessary to reduce transfers and subsidies. These measures are certainly a first step in the right direction, but I concur with the staff's recommendations that some wage cuts are necessary as soon as 1992. My second point is that the resumption of growth in the Congo clearly requires a better allocation of resources to the private sector. I fully agree with the staff's proposals for an overall reassessment of the role that the public sector should play in the economy. The figures concerning employment in the public sector on page 8 of the staff report as well as the significance of the public enterprise deficit clearly call for a comprehensive reform of the public sector to reduce overstaffing and implement other cost-cutting measures. In this respect, the privatization of the oil distribution company (HYDROCONGO) and the restructuring of the transport agency (ATC) need to be undertaken rapidly.

Beyond the restructuring of the public enterprise sector, it is also crucial to make the economic environment more conducive to private investment. This requires that new legislation be adopted, especially to remove price controls and reduce labor market rigidities.

Third, and turning to monetary policy, as rightly stated in Mr. Santos's statement, significant progress has been made in recent years toward reforming the financial sector and tightening monetary policy. Rediscount procedures have been limited and will be progressively eliminated, and interest rates have recently been liberalized.

The main problem now facing the authorities is in the banking sector. The solution has already been formulated, namely, the liquidation of the national development bank (BNDC), and the restructuring of commercial banks.

These reforms will be implemented in early 1992, but in order to ensure their success, they should be accompanied, as planned, first, by the adoption of the new banking legislation in the framework of the regional monetary arrangements of the BEAC. One of the main components of this new legislation is the creation of the new regional banking commission (COBAC), which will be instrumental in enforcing prudential ratios and preventing the recurrence of too accommodative credit practices in the future. The second accompanying step would be the reduction of the Government's participation in the banks' capital.

As far as the external sector is concerned, I will limit my comments to two remarks. First, this chair welcomes the reforms envisaged within UDEAC, aimed at harmonizing the tax system within the Union and at simplifying and reducing customs tariffs. This program, supported by the World Bank, will certainly contribute to fostering trade relations both within and outside the Union, and I encourage the authorities to move forcefully in this direction.

Second, given the debt burden and the level of accumulated arrears, the Congo's external position calls for the restoration of normal relations with creditors and the financial community as a whole.

Finally, my authorities, while aware of the difficulties of a transitional period, encourage the Government to implement quickly the necessary measures to get back on the track of the adjustment process. They stand ready to provide, among others, all the necessary technical assistance to help the authorities pave the way toward the resumption of a comprehensive adjustment program.

Mrs. Krosby made the following statement:

Since August 1990, when its last stand-by arrangement was approved, the Congo has been engaged in an historic process of political reform. We regret, however, that the unfolding democratization has been accompanied by the abandonment of the Congo's stand-by program and a serious erosion of its already precarious economic situation. Indeed, decisions in the last year that have led to the doubling of the government wage bill, the abandonment of important structural reforms, such as the privatization of HYDROCONGO and civil service reform, and the repeal of the domestic petroleum tax have only compounded the Congo's underlying fiscal and balance of payments problems.

It is encouraging that the current transitional government recognizes the country's problems and apparently agrees with the staff's advice. However, we concur with the staff report that stronger actions are needed, even in this delicate transitional period, to stem the deterioration in public finances and external competitiveness until a newly elected government can put a more comprehensive program in place.

The fiscal situation appears completely untenable. It is difficult to see how any country can function for long with nearly 60 percent of current expenditure absorbed by the wage bill; capital expenditure virtually eliminated; mounting domestic and external arrears; and no resources left over for important structural reforms. Against this background, the staff's recommendation for reductions in levels of both wages and unemployment appears wholly appropriate, as unpopular as such a step may be. More broadly, the authorities need to set the country on the adjustment path outlined in the alternative medium-term scenario by boosting revenues from the petroleum sector, along with other taxes and customs duties, and reducing other government expenditures.

Turning to the external sector, a high priority must be given to regularizing relations with external creditors. As noted in the staff report, the accumulation of arrears impedes access to external financing that is desperately needed for structural reform.

Before closing, I would like to mention in passing that we appreciate the staff's candor in the discussion of exchange rate policy--the most frank assessment, in fact, that I recall having seen in a Fund report on a CFA franc country. We take the staff's points that the stability of the real effective exchange rate since 1985 must be seen in the context of administered prices that help contain domestic inflation and in the context of high tariffs and restrictive import quotas that protect large segments of domestic industry. Of course, we also share the staff's concern about the impact of recent wage increases on the competitiveness of the non-oil sector and see this as an additional reason why wage levels need to be reduced.

In conclusion, we appreciate the difficulties that the transitional government has had in trying to implement sound policies in the current political environment. However, we urge the authorities to undertake bolder measures, lest the Congo become saddled with still more intractable problems as it enters a new political era.

Mr. Moss made the following statement:

The staff report before us paints a bleak picture of the actual economic situation as well as the short-term and even medium-term prospects for the Congo. The exogenous shocks which the country has had to face provide just part of the explanation, however; among this type of shock, I would include not only the substantial terms of trade losses which African countries, especially the oil producing ones, have encountered, but also the political upheavals leading to a multiparty system, two elements which are also highlighted in Mr. Santos's statement. Endogenous factors, namely, economic policy errors, have likewise contributed to the country's plight. Here I would just refer to the measures described in the staff report, such as the public sector wage and employment increases or the halting of structural reforms.

Hence, there is precious little time left for focusing attention on the required adjustment, if the latter is to proceed in an orderly way. Even if the current administration has no clear mandate to tackle the vast array of economic problems, it should still act swiftly to halt further deterioration, in order to safeguard its expressed preference, both in economic and political terms. The current Government's action plan cannot, however, but constitute a necessary first step, even if its operational content were to fall in line more or less with the abandoned strategy embodied in the previous stand-by arrangement, and here I fully agree with the staff. Indeed, precious time for adjustment has been lost since the going off track of the Fund arrangement. How costly the last year has been is evident from the extremely large swing in the primary fiscal balance that took place: a deterioration of 11.4 percentage points in terms of GDP--from a 2.4 percent surplus in 1990 to a 9 percent deficit in 1991--far exceeding the 6.5 percentage point widening of the external current account deficit--from 9.7 percent to 16.2 percent, when official transfers are excluded.

The need for a front-loaded program of public expenditure rationalization and public sector reform is therefore evident. Beyond some urgent stop-gap measures, however, a consensus will need to be mobilized on the future role of the state in the Congo's economy. I accept that time is required to achieve such a goal, but the building blocks for reform should be put in place as soon as possible. In the short term, and even in the medium term, such a restructuring is bound to have a deflationary impact, in view of the overwhelming importance of the public sector in the Congo's economy. The best strategy for arriving at the needed consensus is therefore one that offers the prospect of a growth environment in which to undertake the necessary reforms. A consensus will thus have to be worked out also on measures to enhance the competitiveness of the economy, to ensure that private enterprise can and ultimately will take over the labor shed by the public sector, as well as use it more productively so that resources can be freed for future income-generating investment and for paying off at least part of the indebtedness of the past.

In this context, I feel the medium-term adjustment scenario outlined in the technical annex offers perhaps an unnecessarily pessimistic outlook in that it seems to take little account of the dynamic longer-run effects of the envisaged structural reforms on budgetary, and maybe also on export, revenues. Indeed, the assumption of a constant annual rate of increase in non-oil revenues of some 11 percent seems to take little account of the supply-side effects of increasing public investment and reduced unit labor costs. Likewise, the assumption of an exogenously determined growth rate for the oil sector seems to neglect the potential effects of measures to create a more transparent oil sector with greater private sector involvement. Insisting more on these medium-run beneficial effects would, after all, further strengthen the case developed in the staff paper for comprehensive and front-loaded action beginning with this year's budget, an objective to which this chair fully subscribes.

As indicated earlier, such action should also be mindful of its impact on competitiveness. The declining share of investment in GDP--a loss of almost 5 percentage points over the last five years--the very low level of foreign direct investment, and the feeble expansion of private sector credit all seem to indicate that the recorded stability of the real effective exchange rate of the Congo is giving a misleading signal, and that the competitiveness of the Congolese economy is not that brilliant. Maybe the staff could comment. In any event, the deflationary environment for the private sector, as well as the all-pervasive government intervention, greatly diminish the value of a stable price anchor such as the one provided by the CFA franc arrangement. Improving competitiveness by way of devaluation is a priori judged to be precluded, but as in the case of Cameroon, I note the absence of any objective discussion of the pros and cons of the CFA franc arrangement for the Congo. I insist on revisiting this issue, since Mrs. Krosby has just raised it, and also in view of the last sentence of the conclusions of a recently issued working paper on the CFA franc zone (WP/91/133, December 1991), which states: "If welfare depends primarily on price stability and growth, then membership in the zone clearly has benefitted these countries. If welfare depends as well on external balance, and if the nominal exchange rate can be changed in response to persistent adverse terms of trade shocks without sacrificing the credibility of the authorities' commitment to financial stability, then the answer is less clear." The costs and benefits of using the exchange rate instrument in pursuing an adjustment program, which in any event will have to be based on stringent budgetary and incomes policies, would have deserved, therefore, to be spelled out more clearly in the staff paper.

Singling out areas for action which could serve both to reduce the fiscal deficit and improve competitiveness, I would like to underline four measures, which are contained in the staff report: first, laying the basis for a future scaling-down of the public sector in favor of the private sector by restoring orderly financial relations both within the public sector and with the private sector; second, reshuffling government expenditures to enhance their efficiency in general and make room for more public investment in particular; third, creating an environment which is more conducive to competition, domestically as well as externally--as to the latter, the effort will certainly have to be coordinated on a regional level; and fourth, normalizing relations with creditors to get the necessary finance for easing the Congo's external debt burden and for implementing the needed structural measures.

The staff representative from the African Department commented that although it might seem somewhat optimistic to expect from the outset, as a result of the audit, a gain in oil revenues of CFAF 20 billion for the period through 1996, the gap between realized prices and market prices was quite large--on the order of $2.00 a barrel. The gap could, it was believed, be significantly narrowed following an evaluation of actual marketing arrangements and the relationship between the Government and the producing companies. The audit also envisaged ways of changing the financial relationship between the Government and the private companies, with the possibility of new arrangements if the Government received a larger take.

As far as the output forecasts were concerned, the staff representative added, they were based on the information supplied by the producers themselves. In the near term, some new finds might be coming on stream, but the projections provided for minimum increases after 1993; thus, output would be stabilized unless further new fields were discovered or new wells again came on stream.

As for the discussion in the staff report of the exchange rate issue, reference had been made to the conclusion of the working paper on the CFA franc zone, which, however, also mentioned that trends varied from country to country, the staff representative from the African Department stated. The Congo was one case where the structure of the economy was clearly such that the cost reduction measures and the reforms were likely to generate significant efficiency gains, precisely for the reasons enumerated in the staff report: price inflexibility owing to the inefficiency of the public enterprises, wage rigidities in the public sector, and the predominant role of the public sector in the allocation of resources. In that context, the discussion in the staff report of the exchange rate had gone as far as it could; it would be noted that no scenario had been superimposed that would place in relief the possible impact of an exchange rate correction. In any event, given the structure of the economy, exchange rate correction would have its maximum impact only if those structural measures and reforms that had been detailed in the staff report were implemented vigorously.

Mr. Esdar commented that he had nothing substantive to add, but he wished to strongly support the staff's view that a fundamental reorientation of fiscal, monetary, and structural policies was of utmost importance to overcome the economic and financial problems, which had reached crisis proportions. While welcoming the Government's proposed action plan, he shared the view of the staff and other speakers that much stronger efforts, especially in the fiscal area, as well as in the process of reform of the public enterprises, was necessary to regain economic stability.

In addition, a convincing adjustment policy was required to convince creditors that the Congo was addressing its problems effectively and that it was beginning to rebuild confidence, Mr. Esdar added. The dramatic increase in arrears was certainly a major concern in that connection.

On the exchange rate system, Mr. Esdar said that he shared the concern that had been expressed about the fixed exchange rate system perhaps not providing sufficient room to regain external competitiveness. Experience in other countries with administrative prices demonstrated that liberalizing prices and cutting back administrative rigidities often was accompanied by a jump in the price level that might require exchange rate adjustment to safeguard competitiveness.

Mr. Thorne commented that the staff report presented an exceptionally clear case of the need for front-loaded fiscal reform, both to reverse as much as possible of the current year's fiscal expansion before it became too embedded in the Government's cost structure and to send a clear signal that budgetary indiscretions of the past would not be repeated. He welcomed the authorities' action plan, but he agreed with Mrs. Krosby, Mrs. Martel, and others on the need for still bolder reforms.

His chair had often noted that good economics was usually good politics, Mr. Thorne continued, a point that was graphically illustrated by the ill-advised 70 percent pay rise for public employees in 1991, which resulted within months in the Government falling into arrears in those wage payments. If part of the wage rise was not reversed, the medium-term scenario assumption of inflation continuing in the 3 to 5 percent range was extremely implausible. Unproductive spending should be minimized, whether it took the form of excess defense spending, subsidies, or capital projects likely to yield an inadequate return.

Turning to structural issues, Mr. Thorne said that he agreed with the staff that the authorities needed to attach a higher priority to the settlement of public enterprise cross-arrears. Placing public enterprise finances on an orderly basis was an important step toward more far-reaching reforms in the public sector and an eventual program of privatization. Such a step would also help clean up the banks' balance sheets and thereby help to provide extra finance to the private sector.

Although real interest rates appeared in general to be adequately positive, the unreliability of the consumer price index, together with the possible effects of the wage increase, suggested that not too much reliance should be placed on that measure as an indicator of monetary conditions. The authorities' welcome move toward reserve-money programming which was taking place thus took on added importance.

The authorities' restarting of the process of oil sector reform, and especially the early step of an audit to ensure transparency of operations, was welcome, Mr. Thorne stated. His chair also shared the staff's concern that asset sales in that sector should not be used to finance recurrent expenditure.

Mr. Monyake made the following statement:

> At the time of the last Article IV consultation with the Congo in 1990, the Board welcomed the strong initiatives that the authorities had taken to address the severe economic and financial imbalances that the economy was facing following a sharp deterioration in the country's terms of trade. As Mr. Santos has reminded us in his statement, the 1990 program, which was supported by the Fund through a stand-by arrangement, soon ran into serious problems as economic developments diverged widely from the program's objectives in the aftermath of the move toward multiparty politics. The need to address internal and external imbalances has now become more urgent.

The transitional government, which does not have a clear mandate, is faced with very difficult policy choices related in part to the speed of adjustment. There is a real danger that any precipitous and drastic action could seriously jeopardize the very process of economic adjustment in view of the still fragile democratic political environment.

The thrust of the staff's advice correctly focuses on fiscal consolidation. The policy options to achieve measurable progress in this area in the short term are significantly limited. While the staff's recommendation for laying off workers in the civil service and reducing government wages may rapidly achieve a reduction in fiscal outlays, it appears not to be politically expedient during this critical transition period. Instead, the authorities should examine other options for containing the budget deficit through, for example, the withdrawal of certain personal income tax exemptions or the removal of other financial benefits. The Government should also undertake a thorough study of the civil service establishment in order to identify excess staff or even ghost workers. It should, as much as possible, avoid indiscriminate, across-the-board layoffs that could trigger protests and further paralyze economic policymaking.

Another equally important focus of the staff's advice relates to the intensification of the reform measures which the authorities had initiated under the 1990 program. In the particular area of parastatals, the authorities are well advised to seek the assistance of the World Bank not only to provide the necessary financing but, perhaps more importantly, to help in constructing a clear and comprehensive plan of action for privatization and restructuring. This underscores the importance of clearing arrears to the World Bank in order to unlock the much-needed foreign financial assistance.

The reforms in the banking system will be crucial in promoting enhanced efficiency in the financial sector. One is here reminded of the studies published by Villaneuva and Mirakhor as well as the more recent paper by Turtelboom on the liberalization of interest rates in some African countries. Both of these studies stress the importance of a careful sequencing of structural adjustment measures. The staff, in conjunction with the authorities, should develop a careful plan for the sequencing of such structural adjustment measures.

The staff representative from the Exchange and Trade Relations Department said that the general approach of the staff in the case of members of the CFA franc zone was to spell out as specifically as possible what governments would need to do if they wished to maintain the existing exchange rate arrangements of the zone. The working paper on the CFA franc zone to which reference had been made pointed to a number of features of the zone arrangements that led members to continue to maintain them. The working paper noted that since the rapid decline in the terms of trade in the late 1980s, the member countries had faced severe balance of payments problems. The paper indicated the choices from an overall macroeconomic point of view with respect to whether domestic cost reductions could, in a relatively short time, correct for the imbalances, or whether the exchange rate would be an instrument that could achieve a sustainable correction in a shorter time. The last sentence of the working paper, cited by Mr. Moss, came to the conclusion that it was a difficult trade-off issue.

The staff would continue to follow the general approach of stating, country by country, what needed to be done in order to maintain the zonal arrangements, the staff representative from the Exchange and Trade Relations Department added. However, if there was a demand to look at competitiveness more fundamentally in some or all country cases, perhaps with more detailed scenarios or indicators for assessing reliance on fiscal adjustment and the current exchange rate arrangements, the staff would look into the matter. The issue was one of choice and not one that would be clearly determined by economic analysis and, in the end, it was also an issue of choice for member countries with respect to the efforts they were willing to make to maintain the credibility of the zone and to retain its advantages.

Mr. Santos noted that it was clear that Directors shared the staff's assessment of the economic and financial situation in the Congo, which they considered to be very critical. Directors had agreed also with the staff's policy recommendations. Both he himself, in his statement, and the staff had made it clear that the authorities were very much in agreement with both the assessment and the recommendations. The only problem was that of the political constraints in the current stage of the political process in the Congo. The transitional government did not have a clear mandate to go as far as was needed to reform the economy and achieve the necessary balances. The political agenda for the six months ahead was heavy: a referendum on the new constitution in February would be followed by municipal and legislative elections in March and April, and presidential elections in June 1992.

To allay any fears that the Government might not be taking any steps, Mr. Santos said that he wished to join the staff in emphasizing that, even under those burdensome circumstances, some measures would be taken during the first quarter of 1992, or were already in place. The staff representative had mentioned the audit process in the petroleum sector. A great deal of work was also being done to fight fraud in the area of tariffs and customs and to improve and strengthen tax collection procedures. His authorities agreed with the staff that the level of public expenditure, and in particular the wage bill, was unsustainable. While they were contemplating action in that respect as well, they felt limited to what they considered to be their mandate in current circumstances.

To conclude, Mr. Santos thanked Executive Directors for their comments, which he would convey to his authorities.

The Chairman made the following summing up:

Executive Directors expressed concern that key elements of the program supported by the stand-by arrangement approved for the Congo in August 1990 had been abandoned in a period of social and political upheaval. But now, with the weakening of the adjustment effort, the economic and financial situation had deteriorated seriously and, in particular, the fiscal and external imbalances had become unsustainable.

Directors urged the new authorities to implement without delay a comprehensive adjustment strategy to improve public finances, restore transparency in oil sector transactions, and liberalize the economy. In this context, they emphasized the importance of bringing public spending under control, notably through a substantial cut in the wage bill which absorbed a disproportionate share of budgetary resources. This would require not only a reform of the civil service to reduce it to an efficient size, but also an adjustment in pay scales to reverse some of the recent massive increases in salaries. Directors noted with concern that the large salary awards had undermined the government budget, weakened the financial position of enterprises, and eroded the economy's competitiveness as well. Given the Congo's exchange rate arrangements, most Directors considered that it was especially important that wage cuts be implemented, along with price liberalization and measures to reduce costs and labor market rigidities, in order to improve the Congo's competitiveness and bolster the economy's prospects for diversification. Some Directors expressed doubt whether the exchange rate arrangements would leave enough room to restore and maintain competitiveness without adjustment in the exchange rate.

Directors noted that, given the modest projected increase in oil revenues, front-loaded action beginning with the 1992 budget will need to focus also on restructuring and reducing nonwage expenditure. They called for a reassessment of the role that the public sector should play in the economy, the privatization of key enterprises, and a review of expenditure priorities, including the present concentration on military expenditure. On the revenue side, the customs and tax administration needed to be strengthened and the tax on oil consumption reintroduced.

Directors noted the progress made in modernizing and simplifying monetary policy instruments and it was stressed that priority should now be given to reform and rehabilitation of the banking sector.

Directors observed that the buildup of external payments arrears impeded access to the external resources needed to finance structural reforms and other development outlays, and they urged the authorities to work toward normalizing relations with the Congo's creditors.

Directors finally noted that an early start to corrective steps to address the economic and financial difficulties confronting the Congo, while the second phase of the political process was under way, would facilitate the resumption of a comprehensive adjustment program that could be supported by the international financial community.

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

4. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Kyriazidis on the completion of his service with the Executive Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/5 (1/15/92) and EBM/92/6 (1/17/92).

5. SUDAN - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Paragraph 2 of Decision No. 9780-(91/100), adopted July 24, 1991, shall be amended by substituting "by February 14" for "within six months from the date of this decision." (EBS/92/5, 1/13/92)

Decision No. 9908-(92/6), adopted
January 16, 1992

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 91/98 through 91/102 are approved.

APPROVED: July 27, 1992

JOSEPH W. LANG, JR.
Acting Secretary