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Minutes of Executive Board Meeting 86/91

10:00 a.m., June 2, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	E. L. Walker, Temporary
	L. Hubloue, Temporary
	T. Alhaimus
	M. Sugita
	W.-R. Bengs, Temporary
Huang F.	
J. E. Ismael	Jaafar A.
	J. Hospedales, Temporary
	M. Foot
	I. Puro, Temporary
	W. N. Engert, Temporary
E. I. M. Mtei	
	M. A. Weitz, Temporary
	L. P. Ebrill, Temporary
	J. E. Rodríguez, Temporary
	G. Nguyen, Temporary
	V. Rousset, Temporary
J. J. Polak	
	A. V. Romuáldez
	B. Tamami, Temporary
	A. S. Jayawardena
	F. Di Mauro, Temporary

L. Van Houtven, Secretary
S. L. Yeager, Assistant

Also Present

IBRD: A. E. Elmendorf, Eastern and Southern Africa Regional Office. African Department: G. E. Gondwe, Deputy Director; Buu Hoan, M. Dairi, S. Kimaro, R. T. Stillson. Asian Department: H. Neiss, Deputy Director; K. A. Al-Eyd, B. Banerjee, M. Ishihara. Exchange and Trade Relations Department: E. H. Brau, S. Kanesa-Thasan. Legal Department: P. L. Francotte, J. M. Ogoola. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: N. Toé, K. Yao. Assistants to Executive Directors: M. Arif, B. Bogdanovic, V. Govindarajan, A. R. Ismael, H. Kobayashi, T. Morita, A. H. Mustafa, W. K. Parmena, J. Reddy, D. Saha.

1. BURMA - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Burma (SM/86/97, 5/7/86; and Cor. 1, 5/29/86). They also had before them a report on recent economic developments in Burma (SM/86/104, 5/16/86).

Mr. Ismael made the following statement:

My Burmese authorities would like to express their appreciation to the staff for the 1986 Article IV consultation with Burma. In their view, the report provides a fair assessment of the economy.

Burma's economic performance for 1985/86 was mixed. Real GDP increased by 6 percent, a rate slightly higher than that in the previous year, owing mainly to the recovery in agricultural production, partly as a result of favorable weather conditions. Investment activity also recovered after two successive years of decline. The most notable recovery was in the power sector, as well as in the transport and communication sectors. On the external front, the overall balance of payments deficit narrowed sharply, from a deficit of SDR 49 million in 1984/85 to SDR 15 million in 1985/86. However, the external position remained under pressure because of a sharp deterioration in the terms of trade. While export volume recovered strongly, export prices declined by 15 percent. International reserves also continued to remain at a low level.

Inflationary pressures intensified during the year, with prices rising by about 7 percent in 1985/86, following an increase of about 5 percent in 1984/85.

On the fiscal front, the financial position of the public sector deteriorated somewhat sharply, reversing the improvements gained in the previous two years. The overall public sector deficit in 1985/86 was estimated to widen by 1.8 percentage points to 8.7 percent of GDP.

The Burmese authorities view this situation with concern and recognize the need to continue their fiscal adjustment efforts. The budget for 1986/87 reflects that commitment in that it provides for a considerable slowdown in the rate of growth in public expenditure from 12 percent in 1985/86 to less than 3 percent in 1986/87.

On the revenue side, a new rate structure for taxes on income and profits was incorporated in the budget. The primary aim was to reduce the incidence of tax evasion and to improve incentives. With the anticipation of a better performance by the State Economic Enterprises (SEEs), the 1986/87 revenue measures are projected to raise total revenue by 7 percent. The net result of these efforts is expected to sharply reduce the

deficit from 8.7 percent of GDP in 1985/86 to 6.8 percent of GDP in 1986/87. Nonetheless, the overall deficit still remains at a less than satisfactory level.

The authorities are fully aware of the central role played by the SEEs in the Burmese economy. The performance of these institutions must be improved, in their opinion, in order to realize the public sector revenue objective. To that end, the SEEs are now encouraged to implement various measures aimed at improving their efficiency and expanding output. In this regard, the authorities place high priority on the importation of spare parts and raw materials for the SEEs in order to achieve a higher capacity utilization.

The conduct of monetary and credit policies continues to be influenced by the borrowing requirements of the SEEs. Indeed, in 1985, the bulk of bank credit was absorbed by the SEEs. The authorities recognize that the SEEs have been an important source of the increase in demand pressures; but, in their view, the recent activities of the SEEs would have a minimal impact on domestic inflation in the coming period on account of the observed increase in private sector savings. To a certain extent, the recent measures to demonetize some currency notes would also help to moderate demand pressure.

With regard to the interest rate policy, the authorities are not contemplating any action at present. Although the level of real interest rates may have declined to some extent because of the increase in the rate of inflation, the authorities believe that the rate of growth in real income rather than the level of interest rates is the more important determinant of private sector savings in Burma.

The current account position remains weak despite the strong performance of export volume, owing mainly to continued adverse terms of trade. Long-term efforts are being made to increase and diversify exports with some measure of success. The authorities have implemented several export-oriented projects which, they anticipate, will soon be completed. They expect that these projects will eventually contribute to the correction of both internal and external imbalances. Meanwhile, a selective investment policy was introduced to restrain the overall level of public sector expenditure and, therefore, imports. The measures were also aimed at containing the level of external commercial borrowing.

On the exchange rate front, the authorities consider the impact of exchange rate adjustment on exports to be minimal, in view of the centrally planned nature of investment decisions, the administered system of prices, and the high proportion of imports financed by foreign grants and concessional loans. Furthermore, they are concerned that an exchange rate adjustment would exacerbate inflationary pressures.

Debt service payments increased significantly in 1985/86 and are expected to remain high as principal repayments become due. Thus, the authorities are firmly committed to continuing their cautious policy of avoiding nonconcessional borrowing to the greatest extent possible.

In conclusion, I should add that Burma is a country with considerable potential for economic development. It is endowed with abundant natural and human resources. A growth target of 4.5 percent annually over the next four years, as envisaged in the revised Fifth Four-Year Plan, therefore, looks feasible, provided adequate external assistance is forthcoming from international aid groups and foreign governments.

Mr. Jayawardena recalled that at the time of the previous Article IV consultation with Burma (EBM/85/32, 3/1/85), Directors had felt that demand management alone would not be sufficient to achieve economic viability in Burma and that some economic liberalization might be useful in fostering the supply side of the economy. Since then, there had not been much evidence of liberalization of the economy, but there had been several notable achievements. Economic growth had been sustained; growth of GDP in 1985/86 was estimated to have reached an enviable rate of 6.2 percent, aided no doubt by favorable weather. The rate of unemployment had declined and, at 12 percent, was low. After declining for two years, gross fixed investment had grown by 21 percent, with domestic savings growing by 20 percent. The volume of exports had grown strongly, but the terms of trade had declined sharply owing to a 15 percent fall in export prices, and export income had grown by 3 percent. The growth of imports, which had fallen in the previous two years, had recovered by 3 percent. Those achievements deserved commendation.

However, there were strong negative developments as well, Mr. Jayawardena continued. The fiscal position had deteriorated, with the overall public sector deficit rising from 6.9 percent of GDP in 1984/85 to 8.7 percent of GDP in 1985/86. Because nonbank borrowing was virtually nonexistent--probably owing to the evident "cheap money" policy--that part of the public sector deficit that was not covered by foreign finance had been financed entirely by bank borrowing. Domestic credit had also risen faster, and the slower growth of quasi-money essentially reflected the massive demonetization of larger currency notes--an exercise carried out to discourage hoarding and the growing parallel market. All those developments had contributed to the intensification of inflationary pressures during the past year. The staff considered that the rate of real inflation would exceed the official projection of 7 percent. For a country that had long prided itself on price increases of about 1-2 percent a year, that development could prove to be a major setback.

The major area of emerging concern was the balance of payments and external debt service, Mr. Jayawardena remarked. Following an 18 percent decline in terms of trade, the current account of the balance of payments failed to reflect gains in export volumes, and the deficit relative to

GDP--at 3.6 percent--was at the same level as in the previous two years. International reserves had declined to about one month of imports. The debt service ratio as a percentage of total current receipts had risen to 47 percent and was expected to increase. Pressure on the balance of payments was expected to continue into 1986/87 and beyond. The public sector deficit might rise owing to inadequate buoyancy of revenues and weak external performance. For reasons explained in the staff report, the Fifth Four-Year Plan (1986/87-1989/90) might have to be drastically curtailed because of external constraints, which would mean lower growth and tight debt service well into the end of the decade. There was thus reason for extreme caution, and views expressed by Directors during the Board discussion of the previous year had become increasingly relevant.

As to the structure and management of the economy, Mr. Jayawardena observed that Burma's socialist economy was unique. Although central economic planning was the rule in the "Burmese road to socialism," the effective, dynamic part of the economy--namely, agriculture--was owned by the private sector. Unlike the typical socialist economy, where means of production and exchange were publicly owned, the Burmese model eschewed widespread public ownership but used such ownership in a select band of critical economic activities that in turn guided the direction of a larger, often competitive, private sector. Control of external trade, production inputs, and credit allocation gave the state commanding control over the economy and the allocation of resources, whereas markets operated merely as channels of state intermediation. Some other Asian countries had adopted similar policies; thus, a greater familiarity with a system like Burma's might be useful for understanding those economies.

There were many reasons for the evolution of that hybrid form of socialism, Mr. Jayawardena continued. Welfare principles were strongly ingrained in those societies, and they had a long history. Recent studies on ancient hydraulic civilizations--namely, civilizations that relied heavily on collective mobilization of water resources--where interdependence rather than competition was of paramount importance might explain that phenomenon; or perhaps the deeply embedded religious tradition of self-help and mutual aid offered an explanation. Whatever the reason, a concept of state had emerged in which the state provided collective services and used its power of taxation to effect income distribution and the amelioration of poverty. That concept was and continued to be a strong driving force in Asian economies. Aggressive competition--the hallmark of dynamic capitalism--was not necessarily considered a virtue but was perhaps even considered vulgar; the state was the great benefactor, the great leveler, and the great organizer of the economy; and prices in the market did not necessarily reflect supply and demand, but rather the state's priorities in establishing the terms of trade between different sectors. The use of conventional competitive market-related economics to explain those economies would not only fail to capture their essence but could lead to grievious errors of judgment and fallacies of construction. From that point of view, he felt that some aspects of Burma's economy had not been fully captured in the staff's analysis or in the staff's description of the authorities' reaction to its proposals.

Asian hydraulic societies, which were essentially feudal and collective, had retained their basic characteristics through a long colonial phase when their economies were partially transformed by the development of an export-oriented sector that remained distinct from the rest of the economy, Mr. Jayawardena explained. After independence, countries had tried to integrate that sector into the economy while reviving the traditional sector under strong state direction. Because of the backward nature of their economies, only the state could direct that integration through policies that could be characterized as an Asian form of socialism, or perhaps "state welfarism."

State regulation of the economy appeared very attractive in the early stages of economic development, not only because the state could command greater resources, but also because regulation was a convenient means for adjusting to changes in the terms of trade, Mr. Jayawardena continued. But the limits of socialism were reached when economies ceased to be dynamic after achieving their basic life sustaining objectives or when the state's motivation to engender welfare and economic efficiency was exhausted by bureaucratization. At that point, the restoration of market incentives could prove beneficial, as had been demonstrated in other socialist economies.

It was difficult to say whether Burma had reached the stage when change had become inevitable or necessary, Mr. Jayawardena commented. In view of the country's low per capita income--SDR 175--there might be further scope for a regulatory or directive approach. But having weighed the costs and benefits of that approach, he was inclined to support the staff's view that a change in the direction of policy was needed for several reasons. There were indications that economic growth impulses were leveling off; the rate of growth, which had averaged more than 5 percent a year in the past, had been scaled down. Deficit budgets and inflationary financing of those deficits indicated that the limits of fiscal expansion had been reached; moreover, negative interest rates had constrained nonbank financing of deficits. The deterioration in the terms of trade and inadequate incentives for diversification of the productive base beyond subsistence crops had created a difficult balance of payments situation; and adjustment of imbalances through import compression was also reaching its limit. International reserves were low, debt service had risen sharply, and traditional export markets were weak. Historically, Burma had had low inflation rates; recently, however, there were signs of a rising trend. Finally, there was evidence of a growing parallel market. In the absence of positive adjustment, that market would expand, and the state would lose its effectiveness over the economy.

If Burma was reaching the limits of socialist expansion, change would be appropriate and should not be too difficult because Burmese socialism was not doctrinaire, but rather represented a pragmatic approach to domestic realities that was deeply embedded in the country's social and cultural experience, Mr. Jayawardena considered. A starting point

might be the liberalization of financial markets, which would help mobilize greater domestic resources to provide finance in a noninflationary manner. Greater competition among, and commercialization of, the vast array of State Economic Enterprises might be another useful step. The need to diversify the narrow export base might call for greater export incentives; and in that regard, the role of state trading and procurement agencies might be reviewed, with inevitable implications for a more flexible exchange rate regime. Those changes could be achieved within the framework of Burmese socialism and central planning. He encouraged the authorities to consider a comprehensive review of their basic economic strategies in the context of the emerging difficult situation.

Mr. Sugita said that the Burmese economy had been faced with increasing difficulties, partly reflecting the deterioration in the terms of trade during the Fourth Plan period (1982/83-1985/86). Imports and investment spending had had to be substantially cut back in 1983 to avoid depletion of foreign exchange reserves. While the authorities seemed to recognize that prolonged import and investment compression could seriously undermine the country's growth performance, progress in structural adjustment to expand the production and export base--a need emphasized during the previous Article IV consultation--had been disappointing. Burma's per capita GDP remained one of the lowest in Southeast Asia, and there was a clear need to restore conditions conducive to growth and financial stability.

The medium-term projections highlighted the dilemma of the Burmese economy, Mr. Sugita continued. Given the projected high debt service ratio, additional commercial borrowing should be avoided as far as possible. However, to do so, severe import constraints would have to be imposed over an extended period. To resolve that dilemma, more emphasis must be placed on supply-oriented adjustment aimed at export promotion and diversification, improvement in the quality of export commodities, expansion of the domestic production base, and domestic resource mobilization. He agreed with the staff that a greater use of price incentives, particularly in the agricultural and the state economic enterprise sectors, would be necessary even in a centrally planned economy like Burma's.

Export performance had been sluggish in recent years, partly due to the deterioration in the terms of trade, Mr. Sugita observed. The ratio of exports to GDP had been less than 6 percent in 1984/85--an exceptionally low level by international standards--and had shown a declining trend over the past few years. In addition to traditional exports of rice and tea, there were a number of promising areas for export expansion, including nonpaddy crops, hardwood, and mining. To realize the country's export potential, a comprehensive review of pricing policies would be necessary, in addition to further improvement of nonprice incentives. Because of the large discrepancies between government procurement prices and unofficial market prices, a large part of domestic and foreign trade was being carried out in unofficial markets at present, although limited information was available on that development in the staff papers. By taking measures to reduce those price discrepancies, a larger share of transactions would

be channeled into official markets, thereby increasing public sector revenues significantly. In addition, the recent real appreciation of the currency called for more flexible exchange rate adjustment. Although the authorities had been hesitant to undertake those measures because of concern about their inflationary impact, over the medium term, expansion in domestic production through increased price incentives would help to stabilize domestic prices.

The annual plan for 1986/87 targeted a sharply lower real GDP growth rate of 3.6 percent, accompanied by a significant decline in agriculture growth to a rate of only 2.2 percent, Mr. Sugita noted. According to the staff, even that low GDP growth target would be difficult to achieve in view of the external outlook. He invited further elaboration on that point.

On fiscal and monetary policy, he supported the authorities' intention to enhance the selectivity of investment policy by focusing on more export-oriented, less capital-intensive projects, Mr. Sugita remarked. He believed that, in a country like Burma, a relatively high rate of investment was necessary to improve the basic infrastructure of the economy. To achieve a higher investment rate, a much stronger domestic resource mobilization was needed, both in the public and private sectors. The buoyancy of the tax system needed to be increased: total revenues had changed little in nominal terms since 1982/83, while the economy had grown by about 5 percent in each year. A new rate structure for income and profit taxes had been proposed in the budget for the current fiscal year, but since the share of income and profit taxes in total public sector revenue was not very large, the impact of that measure might be rather limited. In the absence of some major revenue measures, the projected revenue increase of 13.5 percent for 1986/87 might turn out to be too optimistic. In view of the importance of the contribution of the State Economic Enterprises to public sector revenue, the financial position of the SEEs needed to be improved. He supported the staff's recommendation to include financial costs in evaluating the performance of the SEEs. Moreover, in view of the recent rise in the Rangoon consumer price index and the possibility that that index might be understating the rate of inflation, interest rates--which had been fixed since the late 1970s--needed to be adjusted. Finally, he supported the proposed decision.

Mrs. Walker said that some recent economic developments in Burma had been positive. Real growth had increased by 6 percent, investment had picked up somewhat, and the overall balance of payments deficit had narrowed markedly. Nevertheless, overall economic developments during the Fourth Plan period had been less positive than during the Third Plan period. Moreover, during 1985/86 the financial position of the public sector had deteriorated sharply--including the decline in the profitability of the State Economic Enterprises--the ratio of debt service payments to current receipts had risen from about 39 percent in 1984/85 to 47 percent in 1985/86.

The outlook for 1986/87, based on implementation of the annual plan, involved the slowdown in growth for all sectors, increased pressure on the balance of payments owing to higher debt service payments and a deterioration in the terms of trade, and a reduction in imports, Mrs. Walker continued. The overall public sector financial position was expected to improve, in part owing to a significant improvement in the SEEs--an assumption that the staff felt might be optimistic.

In the medium-term balance of payments scenario considered "most likely" by the staff, commercial borrowing would be limited, which could lead to a substantial reduction in imports, with a subsequent impact on overall growth that would reduce real growth to a level below the Plan target, Mrs. Walker noted. Thus, in addition to the demand management policies being pursued by the authorities, supply-oriented measures were needed to restore conditions conducive to growth. Although the authorities' choice of economic policy instruments was limited, they should seriously consider some of the measures that had been suggested by the staff.

The poor performance of the State Economic Enterprises was partly due to the limited application of the price adjustment scheme introduced in 1980/81 and extended in 1982/83, Mrs. Walker observed. The number of price adjustments approved through normal procedures had dropped significantly from 1,973 in 1984/85 to 917 in 1985/86. Furthermore, administrative prices had become increasingly out of line with world prices. Additional price increases could help strengthen the financial position of the SEEs. In addition, greater financial discipline in the SEEs sector, including further incentives to limit recourse to bank borrowing, would contribute to improving the profitability of that sector.

The authorities had implemented a more selected investment policy in response to a decline in the terms of trade and a rapid rise in debt service obligations, Mrs. Walker commented. However, she agreed with the staff that unless fundamental changes were made in the incentive structure, that policy was unlikely to bring about a permanent shift of production to the traded goods sector that would support sustained growth and a significant medium-term improvement in the balance of payments. Changes were particularly needed in the agricultural sector, where official procurement prices for most goods had remained fixed since 1977/78. Pricing reforms--including changes in procurement prices, and in the prices of agricultural inputs and domestically marketed outputs--and the provision of incentives through flexible pricing policy would be needed to increase production, promote efficiency, and increase activity in official markets.

The authorities believed that the deterioration in export performance was due to adverse developments in the terms of trade and that nonprice incentives were sufficiently effective in promoting production and exports, Mrs. Walker noted. In her view, nonprice incentives could not bring about the sustainable increases in the export sector that were needed to improve the medium-term balance of payments outlook and secure the desired

growth levels. A more liberal pricing system, accompanied by appropriate exchange rate policy, could also help promote export growth and diversification.

Debt service payments had increased significantly in 1985/86 and were projected to remain high in the medium term, Mrs. Walker remarked. While she welcomed the authorities' commitment to limit nonconcessional borrowing as much as feasible, it might be difficult to do so if export earnings were not sufficient to finance the imports needed to achieve growth targets or if borrowing was used to maintain the level of reserves. Thus, efforts to restore conditions conducive to adequate growth, including demand management and supply-oriented measures, would be needed.

Mr. Huang stated that during the Fourth Plan period Burma had experienced slower growth, higher inflation, and greater internal and external imbalances than during the Third Plan period. Despite the authorities' commendable efforts, recent economic performance had been disappointing, in part owing to unexpected and uncontrollable factors, such as adverse weather and the steep fall in export prices, as well as to an economic structure vulnerable to external shocks and defects in economic management.

Burma's economic structure was characterized by a monoculture, which endowed Burma with a narrow export base, Mr. Huang noted. During the past five years, rice and tea products had accounted for nearly two thirds of Burma's total exports; consequently, the export sector, as well as the economy as a whole, had been adversely affected by the sharp decline in world market prices for those products. Weak economic management, including price rigidities and nonprice incentives, had jeopardized the profitability of the State Economic Enterprises and had contributed to the persistence of a high overall public sector deficit in recent years. Under those circumstances, an undue increase in public expenditure had sharply diminished the financial position of the public sector and had damaged 1985/86 economic performance.

The authorities' intentions and efforts to improve economic performance were impressive, and he agreed with the staff's analysis and its policy suggestions in general, Mr. Huang continued. However, a few points on the design of economic policies in coming years merited attention.

In view of Burma's weak public revenue position, greater importance should be attached to stricter control of public expenditure, Mr. Huang considered. In pursuit of a greater growth rate in 1985/86, there had been a rapid increase in capital expenditures, resulting in an increase in the overall public sector deficit equivalent to 8.7 percent of GDP compared with 6.9 percent the previous year. In the coming years, the increase in public expenditure should be restrained so that the projected ratio of public deficit to GDP would decrease annually or would at least increase no further. In addition, the rapid increase in debt service payments for commercial borrowing had aggravated the pressure on public expenditure. The authorities should adhere to a policy that allowed no new commercial borrowing until the revenue position was improved.

Restructuring the economy should constitute an important element of Burma's medium-term planning, Mr. Huang commented. Indeed, no substantial improvement in economic performance could be expected without structural adjustment. Burma's export base must be widened, but to do so required structural adjustment designed to change a monocultural economy into a diversified one. Developments in manufacturing and processing, mining, and oil production should be accelerated with a view to either reducing imports or increasing exports. In addition, a favorable external environment, particularly in the terms of trade, was vital to Burma's structural adjustment and its economic development. Of course, the establishment of a favorable external environment depended on a concerted effort by the international community.

A substantial improvement was needed in economic management, Mr. Huang remarked. It was most important to give fuller play to market mechanisms, particularly with respect to pricing. The authorities' concern that changes in the pricing system would lead to an acceleration in inflation was understandable. However, by confining administrative pricing to a few major products that were indispensable to domestic production and the people's livelihood and allowing other prices to be regulated by the market, the authorities could achieve both economic stability and a flexible pricing policy. In addition, the management of the State Economic Enterprises must be improved by providing economic incentives, allowing SEEs to operate on a commercial basis, measuring their efficiency by contrasting their operating costs--including financial costs--with their operating revenues, and making them responsible for their earnings and losses. An improved management of the SEEs would lead to a fundamental improvement in the public revenue position.

Burma not only had to adapt its growth to available resources, it also had to reform its economic management and structure, Mr. Huang concluded. That task would be both arduous and long.

Mr. Foot said that he was broadly in agreement with the staff's appraisal. He therefore wished to focus his remarks on the quality of the statistics being used to interpret developments in the Burmese economy.

A centrally planned economy needed a great deal of information, but a reading of the staff paper revealed that the information available to the authorities at present was neither current nor adequate, Mr. Foot noted. The staff, for example, had indicated that the consumer price indexes for Rangoon and elsewhere might be very different. In addition, statements in the staff paper such as "real GDP was officially estimated to have increased by 6.2 percent in 1985/86" clearly implied some doubt regarding the accuracy of the data being used to assess developments.

The demonetization of about one half of Burma's outstanding currency was of particular interest, Mr. Foot continued. That measure provided strong evidence of a large parallel economy. He invited the staff to comment on the nature of the underground economy and its implications for assessing the economy as a whole.

The high debt service ratio was expected to continue in coming years and would not be readily sustainable unless major efforts were made to expand and diversify exports, Mr. Foot considered. He strongly agreed with remarks made by Mr. Sugita and other Directors on the efforts that were needed. Finally, he supported the proposed decision.

The staff representative from the Asian Department remarked that the staff's doubts about the attainability of the 1986/87 growth target were based on the projected decline in real imports and on the projected rate of growth of agriculture, which constituted about 45 percent of GDP. The authorities had estimated that agriculture would grow by only 2 percent, which implied that the nonagricultural sector would have to grow at a much higher rate to achieve an average growth rate of about 3.3 percent. For the nonagricultural sector, there was perhaps a one-to-one correspondence between the level of imports and growth. Since imports were projected to decline by 9 percent in real terms, it was unlikely that the nonagricultural sector would achieve the growth rate--about 5 percent--required to attain an overall rate of 3.3 percent. The staff's view was based on the latest available information, but, of course, exports could perform much better than expected.

It was difficult to measure the impact of the deficiencies in the statistical data on assessing economic developments in Burma, the staff representative continued. The quality of statistics had been discussed with the authorities, and although they had revised some of their methods, there was still need for substantial improvement. The staff was concerned about whether the available official data gave a realistic picture of the country's economy. In fact, when the official figures were revised two or three years later the outturn was usually much different than the initial estimates indicated because there was a tendency for the projections for the current year to be more optimistic than actual economic performance.

There was no accurate way of measuring the extent of the underground economy, but usually, the greater the rigidity in the economic system and the more deep-seated those rigidities became, the larger the underground economy was likely to be, the staff representative explained. For example, in Burma, when the price of rice declined, the volume of rice exported often increased, which implied that when world prices were not sufficiently attractive, more rice was made available through official channels. Conversely, when world prices increased sharply, the volume of rice exported through official channels declined. Such examples of underground activity existed throughout the economy. To the extent that the Government did not capture some of the revenues associated with transactions outside official channels and to the extent that some goods produced by the State Economic Enterprises were resold at a premium in the unofficial market, the public sector position was weakened. Because of the existence of the underground economy, real GDP and per capita incomes tended to be underestimated as was the rate of inflation.

The recent measures to demonetize bank notes, which was clearly intended to capture tax evaders and discourage illegal activity, was a further indication that the underground economy was larger than the authorities could tolerate, the staff representative continued. Statistics on the amount of demonetized currency that had been surrendered were not yet available. Initially, the authorities had decided to redeem up to K 5,000 per person without question--amounts above that limit could be exchanged only upon approval of ownership--and the deadline for surrendering demonetized notes had been December 31, 1985. A black market in demonetized notes had developed immediately, prompting the authorities to amend their original decision to allow only 25 percent of K 5,000 to be redeemed immediately. The remaining 75 percent or amounts above K 5,000 could be redeemed only on proof of ownership. The date for the surrender of notes was also advanced--from December 31 to November 30--to deal with the problem. Under a similar measure in 1964, about 80 percent of the demonetized notes had been redeemed, but the authorities did not expect the present measures to achieve the same success. Moreover, the effort was expected to curb black market activities only temporarily.

One factor influencing the size of the underground economy was the long border with Thailand, which had an impact on the level of trade and which was not very well secured because of insurgencies, the staff representative noted. On the positive side, the underground economy did meet the need for imports of goods and services. Of course, the goods and services provided might not be in accordance with the authorities' priorities or the true needs of the economy.

A review of long-term developments in the external sector revealed that export performance had deteriorated steadily over the past two decades, the staff representative from the Asian Department observed. In 1964/65, exports had constituted about 13.4 percent of GDP; at present they represented about 6.3 percent of GDP. The share of Burma's exports in nondeveloping countries had declined as well as its share in Asian countries. Those long-term trends indicated that the export base was narrow and that measures to diversify and promote exports were needed to enable Burma to achieve balance of payments viability over the medium term.

Mr. Ismael observed that some Directors had stated that a greater use of price incentives would improve overall economic efficiency in Burma and that the adoption of a more flexible exchange rate policy would also improve incentives for production, particularly of exportable goods. While he had sympathy for that viewpoint, his authorities believed that in the context of Burma's socialist system, pricing policy could not play as important a role as it could in market economies. His authorities believed that production depended more on the provision of adequate infrastructure and other agricultural inputs than on pricing policy. For that reason, the Fourth Development Plan had placed much emphasis on investment and infrastructure. A number of programs, such as the Whole Township Program, the Rubber Rehabilitation Program, the

Agricultural Diversification Program, and the program to build new rice mills and storage facilities had and would continue to help increase agricultural production.

The viewpoint expressed by Executive Directors was not inconsistent with the approach adopted by the Burmese authorities, especially toward agricultural development, Mr. Ismael added. That viewpoint emphasized that the Government's investment effort in the form of infrastructure development could be much more productive if it were complemented by the adoption of a more flexible pricing policy, which could lead to increased production, greater efficiency, and fewer leakages to the informal market. He would convey that viewpoint and other comments of Directors to his authorities.

The Chairman made the following summing up:

> Executive Directors were in general agreement with the thrust of the staff appraisal. While the rate of real GDP growth was sustained and unemployment declined in 1985, the underlying economic situation had deteriorated markedly in recent years, with accelerating price rises, considerable repressed inflation, and the growth of the parallel market, as well as a substantial weakening of the balance of payments position, owing mainly to adverse developments in the terms of trade and to rapidly increasing debt service obligations. Although the current account deficit was kept in check through the curtailment of imports, rising debt service payments contributed to the overall balance being in deficit during much of the Fourth Plan period, thereby resulting in the rapid depletion of gross reserves. In addition, Directors noted with concern the decline in public sector savings and the high level of the fiscal deficit despite significant cutbacks in public investment.
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> Directors noted that curtailment of public investment and imports had kept internal and external imbalances under control, but cautioned that maintenance of these restraints would have an adverse impact on future growth prospects. They stressed the need to expand and diversify production and exports through the provision of adequate incentives. While noting that the Burmese economy is fundamentally state planned and regulated, Directors considered the lack of adequate price incentives to be a major cause of the stagnation in rice production and the slow progress of the agricultural diversification program, and expressed the view that an improved price structure was essential for stimulating output and revitalizing exports. In this context, trends in the real exchange rate and the rapid growth of the parallel market clearly indicated that a flexible exchange rate policy was essential to ensure an expansion of the export base and a more efficient allocation of resources.

Directors believed that far-reaching policy changes in a number of areas would be required to restore financial stability and improve Burma's economic prospects over the medium term. In this connection, Directors stressed the need for increased domestic resource mobilization, both in the public and in the private sector. They attributed the persistence of high overall public sector deficits to inadequate expenditure control as well as to the stagnation of public sector receipts, including those sources of revenue that were directly influenced by the overall financial performance of the State Economic Enterprises. Directors welcomed the introduction of a new rate structure for taxes on income and profits, but felt that improvement in the financial position of the State Economic Enterprises, through major price adjustments in particular, was crucial for easing the burden on the budget. Directors considered the rigidity of administered prices to be an important cause of the poor performance of public corporations, both financially and in allocating resources efficiently.

With regard to monetary policy, it was noted that the impact of demonetization on liquidity growth and on inflation was likely to be temporary, and some Directors observed that close attention should be given to controlling credit growth, which had accelerated in recent years. In particular, recourse to bank credit by public sector enterprises should be carefully scrutinized. It was also noted that real interest rates had declined in recent years, and the adoption of a more flexible interest rate policy to stimulate domestic savings and enhance the efficiency of resource allocation was recommended.

Directors observed that debt service payments were expected to remain high over the medium term, and supported the authorities' policy of strictly limiting borrowing on commercial terms. Directors were of the view, however, that the authorities should intensify their efforts to increase and diversify exports in order to mitigate the debt service burden without adversely affecting investment and growth.

Finally, it was observed that there is considerable scope, and need, for improving the economic and financial data base of the Burmese economy.

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

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Burma, in the light of the 1986 Article IV consultation with Burma conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Burma maintains restrictions on payments and transfers for current international transactions in accordance with Article XIV as described in SM/86/97 and SM/86/104. The Fund encourages the authorities to implement policies that would permit a significant liberalization of these restrictive practices.

Decision No. 8295-(86/91), adopted
June 2, 1986

2. COMOROS - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with the Comoros (SM/86/98, 5/9/86). They also had before them a report on recent economic developments in the Comoros (SM/86/99, 5/12/86).

Mr. Mawakani made the following statement:

Despite some decline in inflationary pressures and a reduction in financial imbalances, the overall economic and financial situation of the Comoros remained difficult in 1985. The general economic slowdown experienced earlier continued. For 1986, the general evolution of the main macroeconomic aggregates observed in the past year is expected to continue.

In the real sector, real GDP growth is estimated to have remained stagnant at about 3 percent in 1985. In the agricultural sector, as a result of measures taken earlier with the assistance of international organizations, maize output rose substantially in 1985. Increases in the output of root crops and bananas were also recorded. With regard to export crops, output of vanilla and cloves declined while that of ylang-ylang increased. These developments reflect a combination of several elements such as poor weather, cyclical factors, and price and market conditions. Value added in the service sector benefited from increased trading activity and from investment aimed at improving the transportation and communication networks.

In the fiscal sector, some favorable developments occurred in 1985. While current expenditure increased owing to larger outlays for goods and services, extrabudgetary expenditures associated with the completion of some investment projects fell. On the revenue side, the decline in budgetary receipts is due mainly to a drop in collections from taxes on international trade and nontax revenue. The overall government deficit is estimated to have been reduced by 6 percentage points of GDP in 1985. For 1986, the authorities expect the improvement in the net fiscal position to continue as a result of the introduction of measures aimed at raising revenue and lowering expenditure. The revenue

measures, which are detailed in SM/86/99, include a broadening of the category of luxury goods together with an increase in the rates applicable to these items and in the business tax rates. Steps are also being taken to improve tax administration. On the expenditure side, the authorities have decided to reduce the number of government employees. In addition, housing grants and scholarship awards have been frozen. The Comorian authorities are studying the possibility of implementing additional measures.

With regard to the public enterprise sector, some progress was achieved in the performance of a few enterprises in 1985. Further measures aimed at improving the efficiency of that sector have been taken this year. Moreover, earlier this year, the public enterprise sector was placed under the Ministry of Finance and Economy for closer supervision, and a new charter governing that sector has been adopted.

Monetary and credit policies have been appropriate in 1985. As noted by this chair during the last Board discussion on the Comoros (EBM/85/29, 2/25/85), changes in domestic credit should be judged in the context of the newly created banking system. In 1984 and 1985, the large variations observed in this monetary aggregate reflect mainly fluctuations in the volume of vanilla exports, which dropped sharply in 1984 and rebounded in 1985. For 1986, the authorities plan to continue a cautious monetary policy.

The performance of the external sector improved considerably as the current account deficit was reduced from 31 percent of GDP in 1984 to 17 percent of GDP in 1985. The sharp jump in exports in 1985 was due to the resumption of the sales of vanilla, Comoros' main export. Imports, however, fell because of reduced expenditure on the investment program and lower imports of petroleum products and rice. Imports of these two latter items are expected to return to normal levels in 1986, so that total imports are projected to increase. That increase, however, is expected to be more than offset by a better export performance and an improvement in the service accounts. As a result, the current account deficit is projected to improve further in 1986. The servicing of the external debt remains a cause of concern to my authorities. They are seeking ways and means to cope adequately with the situation.

Over the medium term, the Comorian authorities remain committed to improving the agricultural sector, in particular by encouraging farmers to use more efficient farming techniques and fertilizers. Extension services will continue to be provided. Furthermore, to increase investment on cultivable land, the authorities are studying the possibility of undertaking some agrarian reform. Steps are also being taken to improve the

fishing and tourist industries. The authorities hope that their liberal investment policies will encourage an inflow of foreign capital into the Comoros.

Mr. Rousset remarked that the staff report clearly demonstrated the recent deterioration of the Comoros' financial situation and the mounting difficulties that lay ahead. In view of the seriousness of the situation, he urged the authorities to consider carefully the staff's recommendations. Since he generally agreed with the staff report, he would remark only on fiscal policies and on the productive sector.

As to public finances, significant gains might be obtained on the revenue side, Mr. Rousset continued. That the revenue shortfall attributed to fraud and smuggling activities was estimated roughly at CFAF 2 billion--an amount equivalent to one fourth of the fiscal deficit--underscored the need to strengthen tax collection. He therefore welcomed the authorities' intention to restructure the collecting agencies in order to increase their efficiency.

The agricultural sector was heavily dependent on three main export crops, making the Comoros particularly vulnerable to fluctuations in world commodity markets, Mr. Rousset observed. Diversification was both desirable and feasible; studies financed by several funding agencies over the past years had demonstrated that there were both opportunities for diversification and a strong potential for increasing output through basic improvements. Although some encouraging results had already been achieved, a national strategy for agricultural development was required for further progress in that area. That strategy should include choices regarding the allocation of arable land--such as the agrarian reform mentioned in the staff report--and crop selection.

The authorities attributed the slow and disappointing growth in tourism mainly to high transportation fares, Mr. Rousset noted. While fare reductions would certainly help to encourage tourism--and he understood the authorities were trying to renegotiate fares--the authorities should also focus their efforts on developing tourism-related services, such as tour operators and car rentals. The tourism environment could probably be significantly improved by the establishment of such small-scale enterprises.

Although appropriate actions in the agriculture and tourism sectors could bring medium-term benefits, the Comoros was facing immediate financial difficulties, Mr. Rousset remarked. The most pressing was its debt service repayments. There was no other alternative for the Comoros than to enter into negotiations with its creditors in an effort to study appropriate solutions and avoid any accumulation of arrears. The Comoros would present a stronger case in such a negotiation if it were able to demonstrate its commitment to implementing the adjustment and long-term policies he had mentioned and incorporating those policies in a "recovery program." Action in that direction would also pave the way for a more

active role for the Fund and for the World Bank in the Comoros, all the more so because the Comoros might prove to be a good candidate for use of the structural adjustment facility.

Mr. Mtei remarked that an overview of economic developments in the Comoros was not encouraging. Per capita income, which had been steadily falling, remained--at SDR 265--one of the lowest in developing countries, and the medium-term projections indicated that it would continue to decline until 1991 in the face of a high rate of population growth. Furthermore, in recent years, serious fiscal and external imbalances had emerged, giving rise to an unsustainable debt burden and mounting payments arrears.

While he agreed with the staff that the authorities should embark on prompt adjustment measures, he believed that it was necessary to go further and call for far-reaching and more specific policy measures if the economic deterioration was to be arrested, Mr. Mtei continued. The very low level of growth and development in the Comoros explained to a large extent most of the prevailing economic problems. He therefore wished to focus his comments on the authorities' supply-side and demand management policies.

On the supply side, the authorities' efforts to develop the basic physical and social infrastructure, which had accounted for the high rate of investment--averaging 32 percent of GDP over the last three years--were welcome, Mr. Mtei continued. A number of large projects that had been completed, such as the Mutsamudu Port, the international airport, and hotel facilities, had laid the basis for high potential growth rates, and had established an appropriate economic environment for private investment. Henceforth, a greater share of investment should be directed toward quick-yielding projects with greater impact on income, employment, and the balance of payments. In that connection, he welcomed the attention being given by the authorities to agriculture, industry, fishing, and tourism. The development of basic infrastructure, the revised investment code, the active role of the Development Bank, and the Government's liberal policy with respect to the transfer of profits should lead to greater direct investment and output. However, considerable untapped potential remained in the fishing sector, where there was room for large-scale external technical assistance and possibly a substantial increase in investment. As for tourism, it was regrettable that after having spent considerable resources on an international airport and hotel construction, the hotel occupancy rate was only 25 percent mainly because of high transport fares from Europe. The authorities should redouble their efforts to explore various schemes and options that could lead to capacity utilization in the tourist sector. He would welcome clarification on the role of the World Bank in both the fishing and tourist sectors where, he believed, the Bank could play a leading role. He would also be interested to know the extent of World Bank involvement in the effort to rehabilitate the public enterprises. Because most of the Comoros' problems were the result of a narrow production base, the success of supply-side policies, apart from increasing incomes and employment, would alleviate balance of payments problems, especially in the medium term.

The authorities should also proceed with prompt adjustment measures on the demand management side, Mr. Mtei considered. The recent levels of budgetary deficits were clearly unsustainable, and he commended the authorities for their resolve in the context of the 1986 budget to reduce the deficit from 57 percent of GDP--excluding grants--in 1984 to about 40 percent in 1986. That goal was being achieved through a sharp increase in taxes and a greater tax collection effort, while at the same time public expenditures on employment and other current expenditures were being reduced. To the extent that recent tax reforms had made the system more elastic, the success of the supply-side policies he had mentioned should lead to a faster growth in public revenue so as to progressively narrow the budget deficit. With regard to the large debt service burden, which would reach nearly 34 percent in 1986, he noted that consideration was being given to debt rescheduling; he would appreciate further information on the specific steps being contemplated.

The overall picture of the economy of the Comoros left the impression that the country's problems might be better handled within the framework of a comprehensive Fund-supported adjustment program, Mr. Mtei remarked. In particular, there was a need for setting up a clear and consistent program with targets for growth and for the attainment of a sustainable financial external balance in a medium-term framework. The adoption of a Fund-supported program might also facilitate the needed rescheduling of external debt and arrears. In that connection, the Comoros should avail itself of the resources of the structural adjustment facility and should give due consideration to the use of the World Bank's structural adjustment loan facility.

Mr. Alhaimus stated that the economy of the Comoros continued to be subject to the limitations of a small island economy. Those limitations included more than proportionate expenditures on public administration and provision of public services and physical infrastructure, and far greater impact of developments in the external economic environment than normally felt in larger economies. Those limitations also explained the high capital output ratio in the Comoros, which was projected to persist in the medium term despite the large infrastructural investments undertaken over the years. The extraordinary impact of developments in the external sector had been underlined by the large variations in the monetary aggregates in 1984 and 1985 resulting from changes in the volume of vanilla exports. The Comorian authorities had, however, taken necessary measures in response to adverse developments such as the corrective policies adopted during 1982-83 to strengthen the fiscal sector.

As a result of some of the factors mentioned, the performance of the Comorian economy in 1985 had been mixed, Mr. Alhaimus noted. The growth rate of GDP had remained lower than the rate of increase in population. Tax and nontax revenue had declined, and the effect of that decline on the fiscal outcome had been aggravated by a fall in external grants and the expansion of current outlays. Domestic liquidity had increased considerably while direct foreign investment and inflows of external assistance had registered a substantial decline. However, the overall

effect of those adverse developments had been moderated largely by policy action in various sectors. The overall fiscal deficit had been reduced through a check on capital and investment outlays, which had risen sharply in 1984. In the external sector, a substantial overall surplus had been achieved through an increase of more than 100 percent in exports and through declines in imports and net private transfers. As regards the monetary sector, the expansionary effect of the external sector had been partly neutralized through a fall in domestic credit, and a low level of inflation that had prevailed since 1983 had been maintained in 1985.

Despite those favorable developments, the basic weakness of the economy was at present reasserting itself, and the staff had done well by highlighting its implications for the medium term, although the assumption of a growth rate lower than the growth in population for that period was disturbing, Mr. Alhaimus noted. He hoped that the staff report would facilitate the formulation of a suitable comprehensive and integrated policy package by the authorities. In that task, the authorities deserved all the technical assistance from the Fund and the Bank that they might need. However, the advice already given by the staff on an across-the-board cut in all expenditures should have taken into consideration the authorities' priorities and the feasibility of such measures. The Comorian authorities had already initiated the adjustment process by taking measures earlier in the year for improving the efficiency of the public enterprises and increasing revenues and reducing expenditures, which would further reduce the fiscal deficit in absolute terms and as a percentage of GDP. The cut in private sector credit, effected in 1985, would be restored, but the growth rate of liquidity would be lower than in the previous year owing to the expected contractionary effect of the foreign sector. A weakening in the external accounts was projected for 1986, despite expected continued growth in exports, mainly due to a further decline in inflows of loans and an increase in amortization payments of 112 percent.

The persisting imbalances in the domestic and external sectors called for vigorous and sustained adjustment efforts, Mr. Alhaimus remarked. The most promising area for policy action to effect tangible improvements in production, employment, and exports were agriculture, the utilization of fisheries' potential, and the promotion of tourism. Land reform, which the authorities seemed to contemplate, might contribute to efforts to raise agricultural output. In view of the large infrastructural improvements already accomplished, agriculture and tourism might be developed with a relatively lower capital/output ratio, whereas the mechanization of fisheries might pose a bigger financial problem. In any event, the Comoros needed adequate external assistance at highly concessional terms over the medium term in order to achieve and sustain a growth rate higher than the rate of increase in population. Such assistance was also warranted by the sustained, credible performance of the Comorian authorities over the years in the face of serious difficulties.

Mr. Ebrill said that while some progress had been made, the overall performance of the Comorian economy had been weak. Clearly, every effort had to be made to improve the situation. In particular, future

developments in fiscal policy were crucial. At present, the fiscal deficit remained unsustainably large, despite recent declines. A strengthening of the fiscal situation was essential if the underlying financial structure was to be restored.

Strengthening the fiscal situation would have a direct, beneficial impact on the Comorian external financial position, Mr. Ebrill continued. In that context, he urged the authorities to make every effort to settle their overdue obligations to the Fund and to the OPEC Fund while they were still manageable. He was encouraged that the authorities were aware of those problems, and that, within the framework of the 1986 budget, they intended to eliminate all arrears. He wished the authorities every success and supported the proposed decision.

Mrs. Walker remarked that economic prospects in the Comoros for 1986 continued to reflect the weaknesses that were evident in 1985. Despite measures taken by the authorities, particularly in the fiscal sector, to change that scenario, real GDP growth was expected to decline and the financial weaknesses in the fiscal and external sectors were expected to persist. While progress had been achieved on some fronts, the Comoros was facing continued fiscal and external imbalances that needed serious attention. Policy discussions with the staff had focused on comprehensive adjustment measures to reduce the fiscal deficits and external borrowing while providing for a sustained growth of productive sectors and promoting long-term development.

Fiscal performance in the Comoros had been weak since the early 1980s, Mrs. Walker continued. While a number of corrective steps had been taken, with some improvement on the revenue side, expenditures had continued to rise, resulting in an accumulation of arrears. During 1984, a substantial general salary increase had been awarded. In 1985, the overall budget deficit had declined, but arrears had continued to build up. She urged the authorities to reduce the accumulation of arrears. The financial law of 1986 had introduced some new measures designed to improve public finances, which had caused the overall budgetary deficit to fall to approximately 17 percent of GDP. However, based on identified financing sources, an unfinanced gap of about 5 percent of GDP was expected. The authorities' budgetary aim was to reduce that unfinanced gap and eliminate overdue obligations. In the staff's view, more far-reaching measures than those already announced would be required to reach that goal, including additional measures to discourage tax evasion; reduce waste, redundant employment, and the budgets of ministries; and reinforce budgetary controls. She welcomed the authorities' intention to study the possibility of implementing additional measures. If the budgetary goals were to be reached in 1986, action in that area was urgently needed.

Additional attention should also be given to improving the financial structure of the public enterprise sector, Mrs. Walker remarked. The weak financial structure of the 11 nonfinancial public enterprises was the result of a number of factors, including poor investment decisions. She welcomed the corrective measures taken thus far to begin the

rehabilitation of some enterprises and urged the authorities to continue to work in that direction. Assistance from the World Bank in the preparation of rehabilitation programs to be reinforced by comprehensive audits and reviews of each entity could be useful.

External sector performance had fluctuated considerably from year to year depending upon the export performance of certain products and was expected to remain under pressure in the near future, Mrs. Walker observed. Sizable balance of payments gaps were projected even under the most optimistic assumptions. A reorientation of investment strategy toward the productive sectors was needed, including improvements in agriculture. She therefore welcomed the authorities' intention to expand the tourism and fishing sectors and their efforts to provide incentives for the manufacturing sector. To realize the balance of payments projections, continued inflows of concessional financing would be needed and foreign borrowing would have to be sharply reduced. Debt service payments had reached unsustainable levels, which would persist unless action was taken to restore external balance.

She recognized the difficulties the Comoros had had in developing the basic infrastructure of the economy while trying to achieve sustainable external balances, Mrs. Walker commented. The authorities had taken specific adjustment measures to achieve those goals with the support of development institutions. However, she agreed with the staff that a more comprehensive structural adjustment could strengthen the possibility of achieving changes in the economy that were needed for long-term development.

The staff representative from the African Department remarked that during the consultation discussions, the authorities had asked what role the Fund might play in support of their adjustment efforts. The staff had pointed out that although the Comoros had been using highly concessional loans, at present its debt servicing problem could be exacerbated by the use of Fund resources. The staff had suggested that less emphasis should be put on obtaining financial assistance from the Fund; instead the authorities should perhaps utilize the Fund's technical assistance and policy advice to assist them in formulating a serious adjustment program. Although an adequate adjustment program should focus on structural factors, the staff believed that at present emphasis should be placed on the country's financial problems.

There had been efforts to negotiate a program with the Comoros since the early 1980s, but negotiations had not been completed for reasons that had already been reviewed by the Board, especially in connection with the 1983 and 1984 Article IV consultation discussions, the staff representative recalled. The World Bank had not had a structural adjustment or a sectoral lending program in the Comoros. Because the Fund's contacts with the Comoros in the past had not been as close as they might have been, negotiating a serious program aimed at addressing structural problems would require both extensive preparation to ensure its success and the necessary degree of commitment on the part of the authorities. The

authorities were expected to initiate discussions on adjustment policies on the same day in Washington with the staff of the World Bank and the Fund.

More could be done to improve the fishing and tourism sectors, the staff representative remarked, in connection with Mr. Mtei's comments. At present, a project to promote motorization of boats was being undertaken with the support of Japanese financing. He agreed with Mr. Mtei that more technical assistance was needed in designing projects to promote faster growth in the fishing sector. In the tourism sector, all of the initiatives that were in place or were being contemplated had been reported in the staff paper.

As to debt rescheduling, the Minister of Finance of the Comoros had recently visited Saudi Arabia to initiate discussions on debt rescheduling, the staff representative commented. Subsequently, the staff had been informed that the Comoros was contemplating a donors' conference to be held in Moroni, where the general issue of debt rescheduling would again be raised and the authorities hoped to present a program addressing some of their economic and financial problems.

Recalling Mr. Alhaimus's concern over the relatively low annual rate of economic growth--namely, 3 percent--assumed in the medium-term projections, the staff representative explained that the projected rate of growth reflected rather optimistic assumptions regarding the expansion of export receipts, progress in import substitution, and concessional capital inflows, and an assumed significant shift in the allocation of investment in favor of the productive sectors, implying a substantial decline in the incremental capital/output ratio. Even with those assumptions, disbursed outstanding debt in relation to GDP would continue to increase beyond the present high level, and the debt service ratio would rise to well over 50 percent by 1991. Taking all those factors into account, the growth rate envisaged in the projections was prudent and may even have been overly optimistic.

The recommendations regarding across-the-board cuts in budgetary outlays recognized that while some ministries were making considerable efforts to cut expenditures, other ministries were not making a similar effort, the staff representative from the African Department explained. The staff wished to draw attention to the need to reassess the spending commitments of all ministries in the light of the authorities' priorities with the view to reducing expenditures.

The staff representative from the World Bank observed that contacts between the Bank and the Comorian authorities had not been as close as might be desirable to establish the environment for preparing and executing a full adjustment program involving supply-side measures as well as demand management. That situation would be rectified in the coming months: the Bank's last economic report on Comoros had been completed several years ago, and the preparation of a country economic memorandum was expected to begin with a staff mission in late 1986.

The Minister of Finance of Comoros was in Washington to negotiate an IDA credit for a second education project, the staff representative continued. Although the project focused largely on rehabilitation, it involved a certain amount of new investment. However, before proceeding with a new IDA credit, the Bank considered it important that the Comoros should start to address major overall issues, particularly those related to public finance and investment. Clearly, some expenditure reductions were needed in both those areas, and the authorities had already started to take some measures. The authorities were also starting to tackle the problem of recurrent expenditure in the education sector, which was a major issue in itself.

During the Minister's stay in Washington, the Bank staff would work with the authorities to draw up a preliminary plan of action addressing some major macroeconomic adjustment issues, the staff representative remarked. The measures were expected to deal not only with financial problems but also with the public enterprises, the management of external assistance, and the civil service. Plans for technical assistance were also being discussed; one component of that assistance might be the strengthening of the public enterprises. The French authorities had been working with the Government in that area, and the Bank staff would wish to work closely with them on related issues.

A structural adjustment loan was not being considered at present, the staff representative stated. It would take some time to put together an adjustment program having the depth and the experience behind it that would merit financial support of that kind. Structural adjustment lending might be a possibility in the future, but first, major issues of demand management needed to be addressed.

As to involvement in the tourist sector, the Bank had no experience in that area in the Comoros and no plans, the staff representative from the World Bank explained. The Bank's financial and human resources were extremely limited; in the Comoros it therefore planned to focus its resources in the areas of macroeconomic management, agriculture, and education.

The Chairman stated that the marked deterioration of the economic situation of the Comoros since 1981 was striking. In 1981, the debt service ratio had been equivalent to 3 percent of exports; at present, it was estimated at more than 33 percent. The debt ratio to GDP had been 44 percent in 1981; at present, it was close to 110 percent. The debt situation had also seriously worsened in the past four years. In addition, the current account deficit of the balance of payments, including grants, had increased from 7 percent of GDP in 1981 to a projected 15 percent of GDP in 1986, and the fiscal deficit underlying that resource gap had risen from 11 percent of GDP in 1981 to an estimated 17 percent of GDP in 1986. Revenue in relation to GDP had stabilized over the same period at 12-13 percent, but expenditure, which had already reached 45 percent of GDP in 1981, had exploded to some 70 percent of GDP in 1984 and 60 percent of GDP in 1985. The explosion of public expenditure

was extremely worrisome because it had compounded the country's difficulties and had led to a buildup of arrears and an unmanageable external debt. Undoubtedly, questionable public investment decisions had led to that explosion, which had resulted in recurrent expenditures and high debt service payments. Consequently, in addition to the fundamental task of alleviating the country's poverty, the authorities faced the enormous task of rehabilitating the economy. He was very concerned by what he had read in the staff reports and a lot of work needed to be done to try to redress the situation.

Mr. Mawakani said that he had taken note of the constructive observations and recommendations made by Executive Directors and the Chairman on measures that might be taken to redress the economic and financial situation of the Comoros. He expected to present an exhaustive report on the Board discussion to the Minister of Finance and that the authorities would be initiating discussions with both the Fund and the Bank with a view to putting together a package of adjustment measures.

The Chairman then made the following summing up:

> Directors were in broad agreement with the thrust of the staff appraisal in the consultation report with the Comoros. They noted that in recent years the Comoros had experienced inadequate economic growth in the context of extremely large fiscal and external deficits, and welcomed the measures being taken by the authorities to promote growth and to reduce the financial imbalances. Directors particularly welcomed the authorities' efforts toward raising agricultural and fisheries output, diversifying the economy--including the development of tourism--and strengthening the role of the private sector. In this regard, they commended the authorities for maintaining a fairly liberal system of price, trade, and payments; for revising the investment code; and for strengthening the role of the Development Bank. Directors saw an important role for the World Bank in the development and implementation of appropriate supply policies, investment priorities, and the rehabilitation of state enterprises.
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> Directors expressed deep concern about the large fiscal and external deficits, which have resulted in liquidity problems at the Treasury, an unsustainable debt burden, and increasing domestic and external arrears. They stressed the need for improving resource mobilization through a strengthening of revenue collection and much stronger expenditure controls, and through enhanced financial performance and management of parastatals. Directors noted the authorities' efforts to contain certain types of budgetary expenditure, including a curb of redundant employment. They urged the authorities to act promptly on all these fronts in order to avoid further slippages in the period immediately ahead.

Directors observed that debt service payments had escalated to unmanageable levels, as a consequence of very large investment programs, including infrastructural projects that had not always been financed on appropriate terms. In these circumstances, Directors noted the Comoros' dependence on external assistance on concessional terms. They urged the authorities to embark promptly on strong corrective measures to scale down the fiscal deficits, the size of the public sector, and external borrowing, while stressing the expansion of productive sectors with growth potential.

It is expected that the next Article IV consultation with the Comoros will take place on a 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with the Comoros, in the light of the 1986 Article IV consultation with the Comoros conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that the Comoros continues to maintain an exchange system that is free of restrictions on the making of payments and transfers for current international transactions other than the restrictions on travel allocations as described in SM/86/99.

Decision No. 8296-(86/91), adopted
June 2, 1986

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/90 (5/28/86) and EBM/86/91 (6/2/86).

3. ARGENTINA - STAND-BY ARRANGEMENT - EXTENSION

Paragraph 1 of the revised stand-by arrangement for Argentina is amended by substituting "June 30, 1986" for "May 31, 1986." (EBS/86/39, Sup. 1, 5/29/86)

Decision No. 8297-(86/91), adopted
May 30, 1986

4. POLAND - MEMBERSHIP - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/86/85, Sup. 1, 5/28/86; and Sup. 2, 5/30/86) on the canvass of votes of the Governors on Resolution No. 41-3, with respect to membership for Poland, approved by the Executive Board for submission to the Board of Governors (EBM/86/66, 4/21/86). The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		676,172
Total negative votes		0
Total votes cast		676,172
Abstentions recorded	179,433	
Other replies	0	179,433
Total replies		855,605
Votes of members that did not reply		74,695
Total votes of members		930,300

Decision No. 8298-(86/91), adopted
May 28, 1986

5. DOMINICAN REPUBLIC - TECHNICAL ASSISTANCE

In response to a request from the authorities of the Dominican Republic for technical assistance to advise on the feasibility of introducing a deposit insurance scheme, the Executive Board approves the proposal set forth in EBD/86/156 (5/27/86).

Adopted May 30, 1986

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 85/144 and 85/145 are approved. (EBD/86/152, 5/21/86).

Adopted May 28, 1986

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/120 (5/27/86) and EBAP/86/124 (5/28/86) and by an Advisor to Executive Director as set forth in EBAP/86/124 (5/28/86) is approved.

APPROVED: February 24, 1987

LEO VAN HOUTVEN
Secretary