INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/1

3:40 p.m., January 9, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	Yang J., Temporary
	A. Rieffel, Temporary
	H. S. Binay, Temporary
E. T. El Kogali	L. B. Monyake
	M. Hepp, Temporary
	R. Marino, Temporary
	A. M. Othman
	M. A. Hammoudi, Temporary
	K.-H. Kleine, Temporary
	E. Kiriwat
	L. E. N. Fernando
	L. M. Piantini, Temporary
	W. N. Engert, Temporary
	J.-C. Obame, Temporary
	M. Al-Jasser, Temporary
	M. Pétursson, Temporary
	G. Serre, Temporary
	M. Eran, Temporary
	C. Y. Legg, Temporary
	T. Morita, Temporary
	S. Appetiti, Temporary

L. Van Houtven, Secretary and Counsellor
S. Woolls, Assistant

Also Present

African Department: E. L. Bornemann, Deputy Director; G. E. Gondwe, Deputy Director; C. V. Callender, J. Hiwatashi, J. K. M. Kinyua, T. R. Muzondo, E. M. Taha, T. van der Willigen. Exchange and Trade Relations Department: A. Basu. Fiscal Affairs Department: L. Mutén. Legal Department: A. O. Liuksila, J. K. Oh. Bureau of Statistics: G. J. Robertson. Advisor to Executive Director: N. Adachi. Assistants to Executive Directors: R. Comotto, J. A. K. Munthali.

1. REPORT BY MANAGING DIRECTOR

At Executive Board Seminar 89/1 (1/6/89), the Chairman reported briefly on his recent travel to Senegal and Madagascar.

2. REPORT BY STAFF

At Executive Board Seminar 89/2 (1/6/89), the staff reported, in restricted session, on recent discussions with member countries in arrears to the Fund.

3. MESSAGE OF CONDOLENCE

At Committee of the Whole on Review of Quotas Meeting 89/1 (1/9/89), the Managing Director informed Executive Directors that he would send a message of condolence to the Japanese authorities on behalf of the Executive Board, management, and the staff on the death of Emperor Hirohito.

4. SWAZILAND - 1988 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1988 Article IV consultation with Swaziland (SM/88/269, 12/14/88). They also had before them a background paper on recent economic developments in Swaziland (SM/88/276, 12/23/88).

Mr. Monyake made the following statement:

> My Swazi authorities appreciate the cooperative manner in which the 1988 Article IV consultation discussions were undertaken. They hope to maintain the 12-month consultation cycle with the Fund, which provides them with an opportunity to re-examine the appropriateness of their economic policies.
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> The staff papers under discussion clearly show the satisfactory performance of the Swazi economy in recent years. In 1988, real GDP was expected to rebound strongly while inflation, which had been decelerating since 1986, edged up only slightly. The strong economic expansion reflected increased agricultural output, especially higher sugar production; the recovery of maize and cotton production; and accelerated manufacturing activity. A number of new manufacturing enterprises have been established in recent years, including, in particular, a major soft drink company that completed its first full year of operation in 1988. This rapid economic expansion has also proved beneficial to the economy in terms of employment. For example, formal wage employment was estimated to have risen by 8 percent, in 1987.

Barring the effects of unforeseen exogenous developments, the outlook for the economy in the immediate future and the medium term is considered to be favorable and will depend, to a large extent, on continued private sector production and investment. The authorities are aware that, in order to further boost private sector activity, the present favorable economic and financial conditions have to be maintained, with an emphasis on the provision of tax incentives, and ensuring access to external markets in the region and abroad by maintaining external competitiveness through, inter alia, the pursuit of a prudent wage policy to contain costs. The authorities are aware that the economy remains vulnerable to exogenous shocks, which underscores the need to maintain prudent financial and economic policies.

The current account balance of payments position has strengthened substantially in recent years with a surplus equivalent to about 7 percent of GDP in 1987. The strong performance of exports in 1987 reflected the depreciation of the lilangeni, increased volumes of major export commodities, and improved world prices as well as accelerated output of exports of manufactured goods. As direct investment flows increased, Swaziland was able to build up reserves to the equivalent of three months' imports in 1987, a level that is considered by the authorities to be adequate for the medium term. The authorities consider the liberal exchange regime an important element in attracting direct foreign investment.

Over the years, the authorities have maintained prudent fiscal policies which resulted in relatively small budget deficits averaging 2.4 percent of GDP in the period 1983/84-1985/86. Although the deficit widened to 5 percent in the following year, mainly owing to a precipitous shortfall of receipts from the Southern African Customs Union, the fiscal position strengthened substantially in 1987/88 when an overall surplus amounting to 1.9 percent of GDP was recorded. This positive turnaround was equivalent to about 7 percentage points in relation to GDP and reflected a strong revenue performance, particularly an increase in company tax receipts, owing to the increased profitability of existing industries and the coming on stream of the newly established soft drink company. At the same time, recurrent expenditures were held within budget estimates, assisted in part by savings from personal emoluments that arose from unfilled positions. Furthermore, capital outlays declined, partly owing to the completion of certain public sector projects.

The most recent estimates of the 1988/89 budget show a deficit of about 0.6 percent of GDP, down slightly from the original estimate of 0.7 percent, despite the supplementary spending incurred during the year. The supplementary spending was accounted for as payments for the external debt obligations of the Swaziland Railway Corporation and appropriations to finance an increase in civil service salaries. It should be noted that these salary increases were necessitated by the erosion of real purchasing power, owing to high rates of inflation in the past and the need to retain trained personnel in the country.

The additional expenses were allowed only when it became clear that they would be matched by revenue gains mainly from company taxes. Moreover, higher tax receipts were anticipated from improved tax administration. In this connection, the authorities are aware of the leakages that have occurred owing to the underreporting of imports, and they have taken some measures to reduce tax evasion, including hiring additional staff for the Department of Customs and Excise. Indeed, sales tax collections have improved during the current fiscal year.

The weak performance of some public enterprises has been cause for concern to the authorities. Hence, they are in the process of setting up a monitoring unit to improve the collection of all relevant data that would form the basis for taking appropriate and prompt action whenever necessary. Such measures would, where appropriate, include timely adjustments in tariffs to reflect costs and other relevant developments.

My authorities would like to bring to the attention of the Board a minor point in relation to the monetary sector. The last sentence of the first paragraph on page 6 of the staff report could give a misleading impression as to the role of government borrowing in the expansion of money supply. It was only in 1986 that government recourse to the banking system exerted a clear expansionary influence, since the Government has, for a period of time up to 1986, maintained a net creditor position. However, the authorities agree with the staff that the relationship between movements in broad money and net foreign assets has been close. In the meantime, commercial banks are being encouraged to expand their domestic lending, and, in recent months, they have also been encouraged to retain foreign exchange to cover their net forward sales and to develop the forward market.

In sum, the authorities are in broad agreement with the analysis and recommendations contained in the staff report.

Mr. Enoch made the following statement:

Swaziland rates, in many ways, as one of the most successful economies in sub-Saharan Africa. Its record of success has been achieved despite the constraint of being a small landlocked country dwarfed by a much larger neighbor. Of course, Swaziland has a diverse range of natural resources, but it has not used its resources to try to insulate itself; rather it has sought to exploit its comparative advantages by integrating itself in the world economy. In mobilizing external resources in support of its development, Swaziland has been careful to restrain its resort to external borrowing by relying instead on concessional loans and direct investment.

A key element in Swaziland's success has been its prudent economic policies, which have been used to establish an environment and physical infrastructure that supports, rather than substitutes for, private market initiative. Such a policy stance is all the more commendable given the limitations of the policy instruments available to the authorities. In a small open economy, in which monetary policy is largely externally determined and in which the scope for independent action is further limited by membership in regional customs and trade areas, particular attention must be paid to fiscal policy and the control of domestic costs. The authorities have sustained a strong record in these respects, and the revenue response over the past few years to shortfalls in import duties is particularly illustrative of this record.

The staff report identifies a number of areas in which some tightening of fiscal policy is judged to be advisable--in controlling current expenditure, supervising public enterprises, and enforcing tax compliance--and the staff recommendations seem to be appropriate. Fiscal policy has an important role to play in controlling domestic costs, through the demonstration effect of public pay restraint on general wage discipline. A restructuring of the Swaziland Development and Savings Bank and the further development of the financial sector would seem to be particularly desirable. However, it is reassuring to note that the authorities seem to have adopted an outward-looking approach and have reinforced competition by allowing the entry of foreign banks.

None of the issues presented thus far appear to indicate an emergence of overall policy difficulties. Many of the problems are specific to individual enterprises, and do not seem to reflect any general sectoral malaise. Maintenance of the current policy stance seems to be the best way to address Swaziland's central economic challenge, namely, its vulnerability to external developments. In this respect, further diversification, supported by inward direct investment, would be an optimal strategy. A comfortable cushion of reserves would also appear to be desirable under the circumstances.

One longer-term problem, which raises concern, is the question of population and employment. Unemployment is a serious problem in Swaziland, and the migration of labor into South Africa, where some 30 percent of the Swazi labor force is currently engaged, dramatically increases the vulnerability of the economy to external developments. This factor argues for prudence in economic policymaking.

One interesting policy issue connected with the case of Swaziland is the question of what is the most appropriate monetary and exchange rate policy for a small open economy in Swaziland's situation. Swaziland suffers from a chronically high inflation rate. However, the scope for an independent monetary policy to deal with this problem is clearly limited. Much of Swaziland's inflation is presumably imported from South Africa, which supplies 85 percent of Swaziland's imports. One tool that could be used to moderate imported inflation is the exchange rate, and Swaziland has the option to adjust its exchange rate since regional constraints on the currency have been removed. Of course, such an adjustment would have negative consequences for external competitiveness, but there are costs associated with a continued high rate of inflation. I raise the question of exchange rates in a general sense, and I would be very cautious about suggesting any specific change. Nevertheless, it is an issue that the authorities, and the staff, should keep under review.

Although I note the authorities' desire to remain on a 12-month consultation cycle, Swaziland is a strong candidate for the bicyclic consultation procedure. That Swaziland attaches such importance to consultation with the Fund is welcome, and is obviously to be encouraged, but the purpose of the bi-cycle is to allow for consultations between the Fund staff and the authorities, while economizing on Board discussions. The decision is of course up to the authorities, but I hope that, in making such a decision, they will take the purpose of the bicyclic consultation procedure into consideration, and that they will be able to reconsider their position in the future.

I welcome Swaziland's intention under the regional tripartite agreement to remove common exchange restrictions, which is further evidence of this outward-looking approach. I wonder whether this intention moves Swaziland further toward Article VIII status and whether there have been discussions between the staff and the authorities on adopting that status. Finally, I welcome the regional context of the staff report and, in particular, the appendix on interlinkages with South Africa.

The staff representative from the African Department said that the staff had discussed exchange rate policy with the authorities, but they had agreed that, at the present stage, it was best to maintain the value of the lilangeni at its current level, although it might be desirable to adjust the exchange rate at some future time. The staff was of the view that such a measure could be considered if there was a sustained appreciation of the rand, and, even under such circumstances, the costs and benefits of unpegging the two currencies would have to be weighed carefully. In addition, it should be emphasized that exchange rate policy should not substitute for fiscal policy, particularly given that there were many ways to increase the competitiveness of Swaziland's economy through fiscal policy measures.

The staff representative from the Exchange and Trade Relations Department noted that Swaziland could, in principle, accept Article VIII status immediately, because the remaining exchange restrictions were already subject to the criteria under Article VIII. However, the adoption of such a status needed to be discussed further with the authorities.

The Acting Chairman remarked that it might be useful to examine the degree of flexibility available to the Swazi authorities under their exchange rate policy, in light of the experience of other member countries that had decided to delink their currencies from those of other countries.

Mr. Monyake said that, in light of the dynamic situation prevailing in southern Africa and the close linkages between the countries in that region, his authorities preferred to remain on an annual consultation cycle with the Fund. As Directors knew, the political and economic climate in southern Africa was uncertain, and the region was extremely sensitive to even slight shifts in political and economic policies; that situation called for regular reviews of Swaziland's economic policies and prospects.

As to the issue of population and employment, the rate of population growth in southern Africa was much faster than the rate of economic growth, and job creation in the peripheral areas around the economic core of that region was extremely difficult, Mr. Monyake explained. However, the Swazi authorities were aware of the problems related to employment, and they were seeking ways in which to address them.

The Acting Chairman made the following summing up:

> There was broad agreement with the overall thrust of the appraisal in the staff report for the 1988 Article IV consultation with Swaziland. The economy has performed successfully in recent years, and, as noted in the staff report, this was due to good weather, favorable world prices for exports, prudent domestic economic policies, and an outward-looking economic strategy. Although near-term prospects for investment and growth are promising, it was noted that the economy remains vulnerable to external developments.
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> Swaziland's reliance on market forces and private investment to generate a higher level of investment, growth, and employment was commended. An important supporting role for the public sector was seen in establishing and improving infrastructural facilities and in promoting a climate conducive to private investment in manufacturing and agriculture. The authorities' efforts to promote viable investments in export-oriented and labor-intensive activities were also noted positively; and the

authorities were encouraged to sustain the competitiveness of the economy through the continued pursuit of cautious fiscal policies, including a restrained public sector wage policy.

The importance of maintaining a prudent fiscal policy stance, through improved control over growth in current expenditures, particularly those associated with the wage bill and public enterprises, was stressed. The early establishment of a public enterprise monitoring unit to facilitate the strengthening of parastatal finances on a durable basis was encouraged. Also, some concern was expressed about the weak financial position of the Swaziland Development and Savings Bank.

Both export competitiveness and restrained financial policies were seen as essential for containing the projected increase in the external current account deficit over the medium term.

The agreement reached by Swaziland and the other parties to the Common Monetary Agreement on amendments to that agreement to remove restrictions on payments and transfers for current international transactions was welcomed and it was hoped that those amendments would soon be finalized.

It is expected that the next Article IV consultation with Swaziland will be held on the standard 12-month cycle, although some flexibility might be incorporated in the exact timing of the consultation.

5. EXECUTIVE DIRECTOR

At Committee of the Whole on Review of Quotas Meeting 89/2 (1/9/89), the Chairman bade farewell to Mr. Zecchini 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/88/185 (12/28/88) and EBM/89/1 (1/9/89).

6. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - DECISION CONCLUDING 1988 ARTICLE XIV CONSULTATION

1. The Fund takes this decision relating to exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Sections 2(a) and 3, and in concluding the 1988 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya.

2. The Socialist People's Libyan Arab Jamahiriya maintains restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV. The present exchange system also involves a multiple currency practice and exchange restrictions subject to Article VIII, as described in SM/87/196 and SM/87/208. The Fund urges the authorities to liberalize the exchange system and to eliminate the multiple currency practice as soon as possible. (SM/88/281, 12/27/88)

Decision No. 9054-(89/1), adopted
December 30, 1988

7. ALGERIA - TECHNICAL ASSISTANCE

In response to a request from the Algerian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/373 (12/30/88).

Adopted January 5, 1989

8. CHAD - TECHNICAL ASSISTANCE

In response to a request from the Chadian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/372 (12/28/88).

Adopted January 3, 1989

9. CHILE - TECHNICAL ASSISTANCE

In response to a request from the Chilean authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/371 (12/28/88).

Adopted January 3, 1989

10. TANZANIA - TECHNICAL ASSISTANCE

In response to a request from the Tanzanian authorities for technical assistance in the banking field, the Executive Board approves the proposal set forth in EBD/89/1 (1/3/89).

Adopted January 6, 1989

11. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 88/83 and 88/84 are approved. (EBD/88/369, 12/22/88)

Adopted December 29, 1988

12. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/316 (12/28/88), EBAP/88/317 (12/29/88), EBAP/89/1 (1/3/89), and EBAP/89/2 (1/4/89) is approved.

APPROVED: June 29, 1989

LEO VAN HOUTVEN
Secretary