

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 93/42

10:00 a.m., March 31, 1993

M. Camdessus, Chairman

Executive Directors

J. E. Ismael
D. Kaeser

G. Lanciotti

C. V. Santos

A. S. Shaalan

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Alternate Executive Directors

A. A. Al-Tuwaijri
S. B. Creane, Temporary
M. E. Hansen, Temporary
J. Prader
B. Szombati, Temporary
A. M. Tetangco, Jr.
A. Törnqvist, Temporary
N. Tabata
T. P. Thomas, Temporary

P. Rubianes, Temporary
V. Y. Verbitski, Temporary

I. Martel
J. M. Burdiel, Temporary
M. J. Mojarrad, Temporary
M. A. Hammoudi, Temporary
Y. Patel, Temporary
J. Dorrington
R. Thorne, Temporary
O. Havrylyshyn
Y.-M. T. Koissy
B. Esdar
Y. Y. Mohammed
K. J. Langdon, Temporary
Wei B.

L. Van Houtven, Secretary and Counsellor
R. I. Vera-Bunge, Assistant

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Also Present

IBRD: K. Dervis, Europe and Central Asia Regional Office; J.-L. Sarbib, Africa-Sahelian Regional Office. African Department: M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; G. E. Condwe, Deputy Director; C. Brachet, G. Devaux, P. Dhonte, I. A. H. Diogo, J. Dongala, T. Najah, K.-W. Riechel, A. Tahari, J. C. Tchatchouang, P. A. Youm. European I Department: J. R. Artus, Deputy Director; C. McNeilly, R. Moghadam, M. H. Rodlauer, C. M. Watson. External Relations Department: P.-M. Falcone. Fiscal Affairs Department: E. Sidgwick, C. Van Rijckeghem. IMF Institute: Participants: S. Diakite, G. Nebie. Legal Department: J. M. Ogoola. Policy Development and Review Department: A. Basu, M. E. Edo, P. H. Mathieu, M. Mecagni, J. F. van Houten. Secretary's Department: A. Jbili, A. Mountford. Treasurer's Department: C. A. Hatch, H. Flinch. Personal Assistant to the Managing Director: R. Saunders. Advisors to Executive Directors: R. F. Cippa, Y.-H. Lee, J.-C. Obame, A. Raza, N. Toé. Assistants to Executive Directors: H. M. Al-Atrash, S. Al-Huseini, M. Blome, Deng H., M. Dzervite, A. Galicia, A. Giustiniani, G. A. Heinen, T. Kanada, R. Kibria, J. Mafararikwa, E. Quattrocioche, S. K. R. Regmi, L. Tase.

1. ALBANIA - REVIEW UNDER STAND-BY ARRANGEMENT, AND REVIEW OF EXTERNAL FINANCING

The Executive Directors considered the staff report on the first review under the 12-month stand-by arrangement for Albania approved August 26, 1992 and the second financing assurances review (EBS/93/33, 3/2/93).

Mr. Lanciotti made the following statement:

When the current Government took office just one year ago, after the first fully democratic elections, Albania was gripped by a deep social and economic crisis. Today, after only a few months, the picture has changed dramatically. The courageous decision made by the Government last July to embark on a bold and sweeping program of macroeconomic stabilization and structural reforms, with the crucial support of the Fund and the international community, is beginning to bear its first and significant fruits.

By pursuing firm financial and income policies, the Albanian authorities have succeeded in regaining control over monetary and budgetary developments and bringing real wages to a level more consistent with the large output drop experienced in previous years. The easing of domestic disequilibria has brought about a significant deceleration of the inflationary process. Indeed, the monthly inflation rate has fallen from rates of 10-15 percent in early 1992 to less than 4 percent at the end of the year, notwithstanding the potential inflationary pressure stemming from the removal of almost all the remaining price controls and the sharp increase of the few administered prices still existing.

The significant achievements on the domestic front have been matched by an improvement in the still fragile external position. In the second half of 1992, gross official reserves, excluding gold, increased from one to about three weeks of imports, while the lek exchange rate, after a significant appreciation at the inception of the program, has continued to float with limited oscillations. The process of integration into the world economy has begun by achieving full current account convertibility and by introducing a new and comprehensive foreign investment law.

There is encouraging evidence of a positive response of the real sector to the stabilization and reform measures so far adopted by the Government. The sharp fall in industrial output appears to have bottomed out, whereas agricultural production, following comprehensive price and land reforms, has shown clear signs of recovery. The activity of the newly emerging private sector is gaining momentum. These developments have lessened the severe goods shortages that had been generated by the collapse of the former political and economic system. This, in turn, has contributed to alleviating the critical social situation and maintaining the social consensus on the reform process.

However, this encouraging picture has been partially offset by adverse developments that have made the implementation of the program more difficult than had been already envisaged at its inception. As experience has shown in other economies in transition, this first phase of the reform process has been affected by first, an increase in interenterprise arrears--as a consequence of the combination of a tight monetary policy stance and delays in comprehensively hardening the budget constraints of state-owned enterprises; second, a heavy burden of nonperforming loans that affects commercial banks' behavior and hampers financial sector reforms; and third, a rapidly rising rate of unemployment and declining living standards. The concerns that these adverse developments will raise in the Board are fully shared by my Albanian authorities.

Efforts have been made to address particularly the issue of interenterprise arrears. The Albanian Government should be commended for having resisted pressures stemming from the enterprise sector for a monetization of the arrears, which would have jeopardized the financial targets of the current program. The authorities were aware that the problem required a more comprehensive strategy. The merit of the approach followed by the Albanian Government is that it deals with the stock and flow aspects of the problem simultaneously, avoiding a simple bailout of enterprises. First, the payment system has been radically changed by abolishing the system of receivable orders and by instructing banks to reject any payment order that is not backed by sufficient funds. Second, enterprises have been allowed to charge market interest rates on commercial credits and stop deliveries to enterprises in payment default. Third, a new enterprise restructuring agency (ERA) is being established in order to strengthen financial control over the largest enterprises, while a system for monitoring financial performance of other enterprises is now under development. Fourth, a bankruptcy law has been adopted. Furthermore, the Albanian Government has started clearing the outstanding stock of arrears through a selective process, which differentiates between viable and nonviable enterprises. Enterprises with a net creditor position will be only partially compensated in order to discourage any further accumulation of arrears. It is indeed the firm intention of the Government to proceed within the financial limits of the current program.

Also, Albania has moved more quickly than other economies in transition to address the problem of nonperforming bank loans by recognizing its fiscal implications in a transparent manner. Indeed, in accordance with the advice of the World Bank, the Government has decided to make a one-time replacement of bad loans in bank portfolios outstanding as of end-June 1992 with

interest-bearing Government bonds. The cost of this operation has been incorporated into the 1993 budget.

Continuing along these lines, the Albanian Government has prepared the basis for fostering the restructuring process of both enterprises and commercial banks. This, in conjunction with renewed efforts in the area of privatization, should improve the functioning of emerging market mechanisms and begin to remove the long-standing impediments to growth.

My Albanian authorities are aware that this implies a further strengthening of the policies adopted so far, particularly in light of the high degree of uncertainty and risk still surrounding the ongoing program.

In this regard, it is the Government's intention to limit the effects on the budget of additional burdens generated by the ongoing reform process and by the inclusion of a number of expenditure items excluded from previous budgets. A number of measures have already been adopted in order to strengthen revenues, such as improving the collection of counterpart funds from food aid and broadening the turnover tax base. Continued efforts to reduce the number of employees in both civil and military services and to better target the social safety net should contribute to expenditure control.

As far as monetary policy is concerned, my Albanian authorities are committed to maintaining the current tight stance in order to provide an adequate nominal anchor to the economic system. Progress has been made in widening the range of policy instruments at the central bank's disposal, including reserve requirements and a discount window, but, because the financial system is still at an early stage of the reform process, credit ceilings on individual banks will remain the main instruments through which the Bank of Albania will be able to attain monetary targets. However, it is worth noting that interest rates, although still set administratively with the objective of bringing them to a positive real level by the end of the program period, have already begun to play an allocative role in the Albanian economy, as shown by the shift of household deposits toward longer and more remunerative maturities.

In their anti-inflationary aim, monetary and fiscal policies will continue to be supported by the firm implementation of the current incomes policy that represents the third fundamental pillar of the stabilization process.

It is evident that the road Albania has to follow in order to consolidate the encouraging results achieved in this brief lapse

of time is long and fraught with difficulties. But this does not undermine my Albanian authorities' commitment to the reform-cum-stabilization process.

The economic and social situation, even though improving, still remains very difficult, and the viability of the ongoing program crucially depends on a timely disbursement of the committed aid. Over the medium term, as clearly emphasized in the staff projections, Albania's monumental task of rebuilding its battered economic structure will continue to need a significant amount of concessional financial support from the international community. Notable steps have been already made by the Government in order to define a medium-term strategy conducive to such assistance.

Regarding Albania's external indebtedness, I wish to reassure the Board that my Albanian authorities are exploring all the best possible avenues for a cooperative resolution with official creditors and commercial banks.

I wish to conclude my remarks by expressing my Albanian authorities' appreciation for the support they are receiving from this institution in this crucial phase of the reform process.

Mr. Al-Tuwaijri made the following statement:

Starting from exceptionally difficult circumstances, the Albanian authorities have embarked on an ambitious stabilization and reform program supported by a stand-by arrangement with the Fund. It is encouraging to note from the staff report that policy implementation and financial performance have been broadly consistent with the program targets. In particular, inflation has declined markedly, the fiscal outcome has been satisfactory, and agricultural production has shown signs of recovery. Furthermore, the authorities should be commended for their implementation of significant measures in the areas of price, exchange, and trade liberalization, and in building the key institutional and legislative framework for a market economy.

With the impressive progress achieved during the program, the authorities have embarked on the daunting task of transforming the economy and institutionalizing market-oriented mechanisms. However, as the authorities recognize, this is a long and difficult process that requires perseverance and resolute efforts to consolidate the momentum of adjustment.

In this light, the 1993 budget provides an important, albeit initial, step toward medium-term fiscal consolidation. Indeed, I welcome the measures aimed at social security reform, and the efforts to capture the growing private sector within the tax net.

Notwithstanding the achievements so far, there is a high degree of uncertainty surrounding future budgetary developments.

Consequently, the authorities will need to monitor developments closely and be resolute in their commitment to the program's objectives. Here, I am encouraged by the authorities' intention to introduce contingency measures and reduce the deficit in case of a shortfall in investment.

Looking ahead, it is obvious that additional fiscal consolidation measures will be required. Hence, I fully endorse the authorities' intention to introduce additional plans for price, social security, and tax reforms. In regard to the latter, although I fully endorse the need to raise revenues, I encourage the authorities to introduce broad-based taxes and to improve tax administration, rather than rely on the imposition of higher selective tax rates. Most significantly, durable fiscal consolidation remains contingent on the authorities' ability to limit transfers to public enterprises and to strictly adhere to the wage objectives of the program.

Turning to monetary policy, even though I welcome the introduction of new monetary policy instruments, for the time being, bank-by-bank credit ceilings remain the most significant domestic monetary policy instrument. Therefore, it is important to ensure that these ceilings are adhered to, especially given the anticipated substantial balance of payments support. However, this alone will not be sufficient to contain inflation, as it is imperative to resist pressures to finance enterprises in financial difficulties.

Although major strides are being taken toward financial stabilization, these efforts need to be enhanced through the implementation of wide-ranging structural reforms with particular attention to the problems of the enterprise sector. Here, I fully share the staff's emphasis on clearing interenterprise arrears in a manner fully consistent with the financial framework of the program. Moreover, given the political and social consensus, which has recently emerged, and the increase in financial stability and confidence, now is an opportune time to address the problems of enterprises that were exacerbated by higher than programmed wages and a sharp increase in enterprise arrears. In this regard, I welcome the authorities' intentions to establish a new enterprise restructuring agency, and I hope that this will be the start of serious efforts in this area. Also, although I welcome the recent measures taken to arrest the accumulation of new arrears, I encourage the authorities to apply further measures, including strict and effective limits on budgetary and credit support, greater enterprise efficiency, and binding wage ceilings.

The transfer of small units and the privatization of agriculture yielded a positive output relatively quickly, which helped in alleviating domestic food shortages and in contributing positively to the current account position. However, for the larger enterprises, I endorse the intention to develop a new strategy for rapid privatization.

The success of Albania's program hinges crucially on concessional external support that will be needed to meet large humanitarian needs and provide budgetary financing. Moreover, the burden of Albania's commercial indebtedness must be resolved in order to unlock new private flows.

Finally, with regard to the medium-term outlook, it is heartening to know from the staff report that a comprehensive review of medium-term issues is under way in the context of preparation for a possible ESAF arrangement. Needless to say, I welcome this prospective ESAF arrangement, which would provide an appropriate framework to advance and deepen the process of structural adjustment and reform. A further staff comment on the possibility of moving to an ESAF arrangement immediately after the expiration of the current program would be appreciated.

With these remarks, I support the proposed decision.

Mr. Havrylyshyn made the following statement:

The thorough and informative staff report, supplemented by Mr. Lanciotti's incisive statement, paint a clear picture of the impressive, though not yet completed, achievements in Albania. One is particularly pleased to see these results under the first stand-by arrangement, given the short period of time and the multitude of problems encountered by the authorities: legal and institutional weaknesses, structural difficulties, and foreign assistance shortfalls, among others. Albeit incomplete, the macroeconomic achievements in the second half of 1992 lay a good foundation for further progress in the transition to a market-oriented economy.

Real GDP decline seems to have bottomed out in 1992, reversing its trend by the year-end (an estimated 2 percent increase, compared with a 1.8 percent decline in the first half of the year); inflation was limited to 4 percent per month in November-December, after high rates were recorded following price liberalization in the summer, and the level of gross international reserves amounted to the equivalent of three weeks of import volume (delays in foreign assistance were compensated for by private transfers and capital inflows); and the budget deficit on a cash basis was, in the second part of 1992, less than projected (12 percent of GDP versus 19 percent of GDP), an incredible swing

of 30 percent from the first half 1992. Even the higher programmed deficit for 1993, 22.1 percent, still implies a swing, or reduction, of 20 percent.

The achievements of January and February 1993, according to the latest data presented by the staff, confirm the positive trend that the Albanian economy recorded in 1992. No less important, a great many structural measures have been taken: price liberalization has been almost completed, exchange rate reform is well under way, as is land reform, and important progress has been made in addressing interenterprise arrears. These are all illustrations of the authorities' commitment to the reform process and their decisive action to this end. As a result, one is pleased to see that all performance criteria under the stand-by arrangement, as of the end of December, have been met.

Everything that has been done so far has only been the starting point in the long process that requires sustained efforts on the part of the authorities and greater support from the international community. For the program to continue, I fully agree with the staff's recommendations that accompany the review. There are only a few points upon which I have some comments.

The tight fiscal policy that the authorities have adopted, with measures aimed at strengthening tax collection and broadening the tax base along with a cut in expenditures, which brings real wages in line with inflation and the number of civil servants to a more acceptable level, is very commendable. Introducing items previously excluded into the budget and setting an ambitious target for investment are also measures in the right direction.

Nevertheless, the projected deficit for 1993 of 22.1 percent is still very high by any standards and certainly unsustainable beyond 1993. I would appreciate the staff's views on these two questions. First, is there already some prognosis or expectation of whether, on the target date, the budget deficit will be reduced to a more sustainable level? The second question concerns lessons for other transition economies, many of which--once a transparent budget has been calculated--have experienced deficits nearly as high as Albania's deficit of 42 percent. Let me explain further. On the surface, Albania's performance may be interpreted as a successful gradual reduction of the fiscal imbalance and of the related inflation. Other countries may be tempted to think that they should follow Albania's example, rather than make difficult political efforts to cut deficits quickly from 30 percent or more to below 10 percent in less than one year. I, for one, would hesitate to support such an interpretation, and I would appreciate it if the staff could provide the intellectual ammunition to argue whether Albania's experience might or might not be reproducible elsewhere.

With respect to structural measures, recognizing the seriousness of the interenterprise arrears problem, I fully agree with the authorities' actions so far and encourage them to continue. I would like to recommend only that they monitor the selective clearing of outstanding arrears closely, because the facility can be easily claimed by other enterprises that are not entitled to it through a kind of moral suasion, and that could reverse the results and jeopardize the tightness of monetary and fiscal policies.

I also hope that the restructuring progress seen in the agriculture and services sectors will be quickly extended to the enterprise sector, as is needed to guarantee continuing reform. The establishment of the ERA is a good step, as are the laws on bankruptcy and foreign investment. Here the role of the World Bank and IDA is crucial, and I welcome their commitments for 1993 and 1994.

To conclude, I support the proposed decision and concur with Mr. Lanciotti that the "monumental task of rebuilding" will continue to need significant concessional support. The Albanian policies' steady progress so far in that direction will facilitate quick and effective organization of such support, including a possible follow-up ESAF arrangement.

Mr. Tabata made the following statement:

It is commendable that the cautious and prudent fiscal and monetary policies implemented by the authorities have reduced inflation and inflationary expectations gradually, and, at the same time, picked up the economy. In particular, the fact that real GDP this year is projected to increase by approximately 2-3 percent, more than expected, is welcome. However, much remains to be done in the fiscal, monetary, and structural areas.

With regard to fiscal policy, the budget deficit as a ratio of GDP is projected to be more than 20 percent this year because of the expected increase in expenditures relating to, inter alia, enterprise reform, unemployment, banking system restructuring, and interest payments on government debt. In these circumstances, it is imperative by all means that fiscal consolidation be achieved. Reforming the social security system, improving tax administration, and restraining public sector personnel outlays are all the more important. In particular, the implementation of a strict incomes policy, the anchor of the current program, is expected. In light of the experiences of some economies in transition that allowed an increase of real wages and came to a deadlock in reforms, the authorities should maintain flexibility with respect to real wages.

On the monetary front, the authorities should establish a banking system that includes an improvement in the central bank's institutional framework and the creation of monetary policy instruments. At this juncture, the initial stage of reform, I believe that direct controlling measures are effective for the implementation of monetary policy. With these changes, maintaining positive interest rates is all the more important to reduce inflation and inflationary expectations further.

With regard to structural reforms, the authorities plan to implement a variety of measures, such as price reform, enterprise restructuring, financial sector reform, and land reform. In spite of the fact that all of these are, needless to say, important, considering the scarce resources and limited government capacity, it is necessary to prioritize these reforms.

On the external front, it is urgent that the authorities normalize relations with commercial banks and bilateral official creditors, in order to attain external viability in the medium term. The financial gap in the second half of this year is still open. Additional contributions by EC countries are expected.

Finally, I strongly expect that the Albanian authorities will continue their cautious and prudent implementation of fiscal, monetary, and structural policies during the remainder of the program period and build up a good institutional framework, as well as a sound economic infrastructure, which will surely lead Albania to sustainable growth. In this context, I expect that the ongoing negotiation of an ESAF arrangement will succeed.

With these comments, I support the proposed decision.

Mr. Esdar made the following statement:

When we first discussed the stand-by arrangement with Albania, some Directors pointed out that there were considerable downside risks. Some of these risks have materialized: the disbursement of donor assistance has been slower than envisaged; excise tax collection has lagged behind expectations; the wage level, particularly in the state enterprise sector, is much higher than what had been envisaged as necessary under the original program; and interenterprise arrears have risen at a rapid pace.

Against this background, it is commendable that the program has remained basically on track and that Albania's economic performance in some areas has been better than expected. It is particularly noteworthy that the decline in output has been reversed sooner than expected, which is related to the recovery in agriculture production. This certainly confirms the strategy of focusing attention on the rehabilitation of the agricultural sector. Therefore, I would like to encourage the authorities to proceed

further in this area and, in particular, to remove the still remaining uncertainties regarding property rights on land.

I can endorse the staff appraisal, and I have only a few points to add, which I would like to address. The budget has performed better than expected, with the cash deficit and, accordingly, the recourse to bank credit remaining below the program ceiling. However, the structure and sustainability of the underlying fiscal adjustment are confronted with uncertainties. Excise tax revenues have lagged behind expectations, as tax administration has to be further developed and improved. This raises doubts whether the 1993 revenue targets can be met despite the welcome intentions to improve tax administration.

The improvement on the expenditure side is basically a reflection of the substantial shortfall under the item "net lending," and I would like further explanation of this position. At the same time, spending on maintenance has remained below the envisaged level, and, notwithstanding its beneficial impact on the budget deficit, it is somewhat worrisome to read that the expenditure shortfalls are "partly related to administrative weaknesses."

Against this background, I wonder whether the expected large increase in investment expenditure in the budget for 1993 is a realistic target. There is no question that the investment needs to improve Albania's infrastructure are immense; however, given the weakness of administrative capacities, I would caution against too ambitious spending targets and argue for a concentration on a few selected investment projects with high returns. It would be most unfortunate if scarce resources are wasted because Albania's absorptive capacity was overestimated.

The prospects for the public sector deficit in 1993 remain worrisome, with domestic bank financing of the Government accounting for 11 per cent of GDP. This seems to be unsustainable in the medium term, which is hard to reconcile with the need for sustained financial stabilization. A further substantial adjustment in the budget seems necessary if any substantial reduction in inflation is desired. As mentioned by other speakers, strict control of the wage bill and a streamlining of spending on social security items are essential in this respect.

Money and credit growth was lower than expected under the program. This, again, has to be judged with a certain degree of caution, given that it reflects somewhat the weakness and inefficiency of the banking sector and state enterprises. The need for a reform of the financial system is emphasized in the staff paper, and I strongly agree with this recommendation. However, I have a question on the treatment of interenterprise arrears.

Arrears increased by lek 9 billion between June and November 1992, which is equivalent to more than 25 percent of GDP. The rise in interenterprise arrears is jeopardizing the survival of potentially viable enterprises, too. The authorities have recently implemented a number of measures to prevent a further rise. I wonder, however, why these measures have not been put in place right at the outset of the program. After all, the emergence of interenterprise arrears was predictable, and I believe that any further reform of the state enterprise sector would have been facilitated by addressing this issue at an earlier stage.

The plan to remove arrears will, as the staff paper says, involve "a major penalty for creditor enterprises through the write down of net creditor positions." I would like to know what this means for the viability of these enterprises. A comment from the staff would be welcome.

Finally, Albania's balance of payments outlook remains bleak. It is clear that medium-term viability will require substantial financial support from the donor community. Therefore, as stated in the staff report, a solution to the external arrears problem is essential to establishing normal relations with Albania's creditors. Accordingly, I urge the authorities to address this issue without further delay.

I support the proposed decision.

Ms. Creane made the following statement:

Reading through the staff report on Albania's progress under the stand-by arrangement, one cannot help but react with hope, but hope tempered with concern. Against the background of an extremely difficult economic and sociopolitical environment, Albania has moved forward to stabilize and transform its economy on market foundations. That the authorities have managed to pull out a performance that largely complies with the program's objectives, if not entirely as originally planned, sparks hope about the long-term commitment and ability to conclude the process of economic adjustment. The level of private inflows and relative stability of the lek's exchange rate are a sign that the market also finds credibility in the stance of financial policies and the pace of reform.

Even though the authorities have successfully managed to stabilize the economy against tough odds, it is potentially only a temporary stabilization. This is where concern enters the picture. Some of the factors that converged to produce the positive outcome to date will not be repeated in the future. Key structural reforms have yet to be put in place that are requisite

to lasting economic stability. And new challenges loom ahead, such as the fiscal and social impact of growing unemployment.

Regarding the fiscal accounts, we recognize how far the authorities have come in whittling down the size of the fiscal deficits and attendant domestic financing by half in 1992. However, the deficit goal of 22 percent of GDP this year is still very large, even if only half is meant to be financed through the domestic banking system. It implicitly assumes a larger adjustment than in the 1992 budget, given the nonrepetitive means by which last year's result was realized. Part of the lower than expected level of expenditures in 1992, rather than being due to structural changes in the fiscal accounts, was due to administrative delays. I hope that for the overall efficiency of the public accounts, these administrative problems will be redressed in the future. Furthermore, substantial suppression of needed expenditures on maintenance last year and this year cannot be indefinitely sustained. However, there are several new expenditures included in the 1993 budget that are one-time or temporary and should assist in the longer-term stabilization process. These include the funds devoted to enterprise and banking sector restructuring, and the higher outlays on unemployment benefits. Given the increasing level of unemployment benefits, accurate targeting of these, combined with the programmed lid on the wage bill through containing both costs and numbers, is essential.

We support the intention to raise investment expenditures, assuming these expenditures are carefully vetted for quality and priority within the medium-term plan. However, we stress heavily the importance of cutting back on investments or other expenditures should projected nondomestic financing not materialize.

The strongest concern in 1992, the potential negative repercussions from the buildup in interenterprise arrears, seems to have since then been brought under control. The backtracking on wages last year posed a problem for the further accumulation of enterprise arrears, as well as for the role of real wages as the nominal anchor. For these reasons, any new pressure to offset the programmed changes in real wages this year should be strictly resisted. But the progress since seen in addressing the enterprise arrears problem is due to well-thought-out and implemented measures. The hardening of the budget constraint by limiting easy credit, backed up by changes in the payments system, and tied to fundamental reforms of the enterprises seems to have been effective in stopping the accumulation of new arrears. It is interesting how much the netting of cross arrears substantially reduced the overall level, and it is an indication that the final burden on creditor enterprises will not be so heavy as to be crippling,

but would effectively serve as a disincentive to future arrears accumulation.

The lower than expected domestic bank financing of the budget last year by 4 percentage points of GDP, together with the lower than programmed credit to the nongovernment sector, may have had an impact on the lower than expected inflation rates already visible this year. But, as already observed, some of the particular factors that helped lead to a smaller than expected fiscal financing need in 1992, will not, I hope, be repeated this year. Furthermore, credit to the nongovernment sector was also down for reasons one might hope will not be repeated, such as weaknesses in the banking system and the deteriorating position of public enterprises. In addition to the potential positive effect on inflation, these factors also contributed to a better than projected outcome on the external accounts. As in the fiscal accounts, I hope that many of these temporary stabilizers in 1992 will, for the longer-term good of the economy, be unwinding in 1993, serving to make even stronger the need for the authorities to hold the line strictly to the program's credit targets.

On structural reforms, as the staff points out, some of the toughest measures needed are still ahead. Notwithstanding the responsiveness already forthcoming in the agricultural sector from reform measures already taken, further structural reforms there, as the sector that is the strongest source of near-term future growth, should not be forsaken. For example, we would strongly urge moving forward quickly on allowing the sale of land. Continuing reform of the banking system is also important to allow the most efficient allocation of financial resources. And, now that the problem of interenterprise arrears seems to be under control, we look forward eagerly to fundamental changes quickly being enacted in this sector, including the setting up of the enterprise restructuring agency and moves to liquidate or privatize enterprises. We would hope to see concrete steps and a timetable on next moves in the public enterprise sector at the time of the next Board review.

Growth and inflation prospects for 1993 are brighter for Albania than for the other Central European countries as a whole. The liberalization of the agricultural sector and consequent availability of food products should, I hope, have a positive impact on maintaining the necessary sociopolitical stability as the economic adjustment process moves ahead. We do have some concern that the potential transitional negative effects that structural change might have during the reallocation of resources in the industrial sector are still to come.

Finally, I am pleased to see that the Albanian authorities are framing their 1993 program expectations within the context of a medium-term plan that could provide some input into a follow-on

ESAF program. It is because of the progress made to date on economic adjustment in Albania that we are all the more concerned about the risks in the future should there be any temptation to stray from the program.

Mrs. Martel made the following statement:

I continue to be favorably impressed by the results obtained so far, despite the exceptionally difficult circumstances, in the course of Albania's stabilization and reform process. Indeed, macroeconomic performance criteria were met in both September and December of 1992. Last year's fiscal deficit was below the program target--even though it would only be fair to point out that this achievement was due partly to administrative weaknesses and delays in foreign assistance. At 4 percent per month at the end of 1992, inflation conforms to the program's forecast. In addition, the exchange rate has been stable for the second half of 1992, and reserves have risen broadly in line with program targets.

It is also most welcome that reforms are beginning to take root, that the sharp decline in output has been arrested, that, as a matter of fact, a good supply response is being registered in the agricultural sector, and, finally, that the consensus on the ongoing process has been maintained. The continuation of this consensus will be especially needed during the next few months.

Indeed, financial policy will be put under increasing pressure, given the situation with regard to unemployment and enterprise arrears, and structural reforms will enter a new, more complicated phase. In such circumstances, the following will be crucial: first, to maintain the orientation toward sound financial policy, indeed, as the staff has stressed, "any slippages may risk all that has been achieved so far"; second, to have all areas of economic policy, including incomes and exchange policies, contribute to the stabilization and reform process; and, third, to prioritize very carefully the actions to be taken, especially with regard to structural reforms, in order to maintain the momentum, but also not to overburden a still fledgling institutional framework.

As I am in broad agreement with the staff's and prior speakers' assessments and recommendations, I will limit myself to a few brief comments that will be made in light of the three requirements I have just mentioned.

First, as to fiscal policy, the bank-financed deficit projected for 1993 is still, at more than 11 percent, quite high. But we concur with the staff that the underlying effort is substantial, given the inclusion of crucial and previously excluded

items, for a total amount of 9 percent of GDP. Also, the announced fiscal package provides for welcome quantitative and qualitative improvements; we encourage the authorities to implement it fully, especially with regard to the broadening of the tax base--including the agricultural sector--the fostering of tax administration, the reduction of government employment, and the accompanying progress toward a targeted social safety net. We also appreciate the authorities' commitment to take further action if necessary and the ongoing effort--conducted in cooperation with the World Bank--to review public investment projects.

Second, the contribution of incomes policy cannot be overstated, given the slippage in wages registered last semester and the continuing need to improve the price performance and minimize employment losses. Thus, it seems quite appropriate to provide economic agents with a nominal anchor and keep wage developments under close review while allowing, within certain limits, firms in a satisfactory financial situation to have a degree of flexibility in wage setting.

Third, monetary policy might well prove to be the area where tensions will crystallize. On the one hand, while the financing needs of the Government will remain high, some degree of uncertainty could persist in foreign assistance, and the authorities envisage increased use of credit by the nongovernment sector. On the other hand, there is a need to protect the disinflation performance and, thus, to reduce the rate of growth of the monetary aggregate. In such circumstances, we welcome the authorities' reiterated commitment to reach positive real interest rates by the end of the program and their intention to raise nominal interest rates further if needed. We also fully concur with the staff that developments concerning the exchange rate should constitute an essential indicator for the conduct of monetary policy.

As regards the difficult problem of interenterprise arrears, we join the staff in praising the authorities for having chosen an approach that closely links the clearing of past arrears to progress on the issue of budget constraint and to preventive measures in the area of payment systems.

Taking now a more medium-term perspective, I agree that progress should be made in establishing instruments such as reserve requirements or treasury bills that will allow, in due course, for the shifting to indirect monetary control. However, in the current situation, characterized by limited administrative capacities, by multiple needs for other reforms--including the reform of the weak structure of the banking system--and by the remaining progress to be made in terms of stabilization, I would caution against any precipitous moves to implement a shift toward indirect controls. This issue should certainly be kept in mind during the preparation of the forthcoming medium-term agreement and was

addressed by a number of other chairs during our recent review of ESAF programs.

Finally, concerning other aspects of the structural reform agenda, I have noted the substantial progress registered in the privatization of land, and small retail and service enterprises. I look forward to the reform allowing for the sale of land and to the next stages of the enterprise reform, which will certainly include further restructuring and divestiture of medium-size firms.

In conclusion, I will say, first, that I concur with the staff on the crucial character of foreign assistance for Albania; I welcome, in this regard, the disbursement last January of the first tranche of the EC grant, and I hope that other contributors will allow for a balanced burden sharing to prevail. Second, in view of Albania's serious efforts, I fully support the proposed decision.

Mrs. Szombati made the following statement:

The Albanian authorities are to be commended for the way they have coped with the numerous challenges and obstacles to their ambitious transition program, keeping the program on track and observing all program targets.

During the past few months, Albania's inflation has declined markedly, the fiscal position has exceeded expectations, and the program's monetary and external targets have been met. Even more encouraging, the process of privatization, price and exchange liberalization, and the establishment of a basic institutional and legislative framework for market operations are under way. In response, the sharp output decline has halted and agricultural production is showing the first signs of recovery.

These results mark important progress toward stabilization and structural transformation, but as the staff points out, Albania is still in the very early stages of reform, and its achievements are fragile and still vulnerable to the severe financial imbalances and structural damage caused by the former rigid planning system. To achieve a moderate recovery in real GDP growth with a further reduction in inflation and an essential improvement in the external position, the Government will have to implement still broader structural reforms while maintaining the present tight fiscal and monetary stance. The continuing need for rapid domestic adjustment will require vigilantly implemented incomes and expenditure policies, together with a well-targeted safety net to avoid loss of social support. Owing to Albania's severe external payments situation, the country will also need

substantial external financial assistance to maintain its external viability and support the implementation of the program.

The authorities have rightly focused on the program policies on enterprise and financial sector reform and on strengthening their macroeconomic stabilization with a package of fiscal measures designed to minimize the risks and difficulties the program faces. I will comment briefly on the two policy areas of structural reforms and financial policy.

Albania has already made rapid progress with the comprehensive price and exchange system reforms, and I note with satisfaction that the authorities intend to continue the process by completing price liberalization and strengthening the exchange system. I share the staff's view that further progress with trade reform now calls for eliminating the remaining trade restrictions and abolishing monopolies. The latter goal would be well served by the early privatization of the state trading enterprises.

As the scope of structural reforms becomes broader, it is important to ensure that progress is appropriately focused and sequenced. Clearly priority should be given to enterprise restructuring efforts, as large accumulations of interenterprise arrears and the granting of unconditional budgetary and credit support to loss-making enterprises pose a serious risk to both fiscal and monetary adjustment. The clearing operation of interenterprise arrears requires a proper solution, strict enough to avoid a widespread bailout, but flexible enough not to make the already severe adjustment process any harder to bear. I am pleased to learn from the staff paper that the Government recently took successful steps to clear up nonperforming loans and halt the accumulation of new arrears. In this connection, the comprehensive enterprise restructuring program supported by the World Bank's enterprise and financial sector structural adjustment loan (EFSAL), which includes the creation of a new enterprise restructuring agency, is most welcome. But it is still only by fundamentally improving the efficiency of enterprises and changing the payments system that this problem can be durably solved. It should also be noted that, although the state has a fundamental role to play in the enterprise restructuring process, participation of the private sector, both foreign and domestic, will greatly speed the process of introducing market principles into enterprise management.

Reforming the financial sector is another most urgent step toward effective indirect monetary control and toward the orderly clearing of nonperforming loans. Priority should, therefore, be given to strengthening the central bank and creating an efficient commercial banking system. A viable, market-oriented financial sector is also needed to attract and channel the private capital inflows that will play an increasing role in Albania's recovery.

The third important area for structural reform is land reform. Here, privatization is nearly complete. Early elimination of the uncertainties stemming from former owners' claims and a new law on the sale of land are the next steps needed to induce a supply reaction in Albania's badly damaged agricultural sector.

Financial tightening is still the crucial element of Albania's adjustment and reform effort. In the fiscal area, this will not be easy--the budget for 1993 includes several previously excluded expenditure items and a large increase in investment, and social constraints are also increasing. The large fiscal deficit projected for 1993 once more reflects the devastated tax base and increasing pressure for expenditures. Nonetheless, we agree with the staff that the authorities' fiscal package shows a substantial effort to limit the effects of the additional burdens. With serious tax and other revenue-increasing steps and cuts in civil and military services in place, the authorities are making progress toward a more sustainable fiscal structure. Given the medium-term nature of the fiscal imbalance, further consolidation will clearly require further steps, including additional price reform, extension of the tax base to cover agriculture, and improvements in tax administration and collection.

Monetary policy should tighten credit policy toward enterprises in order to contain broad money growth. The positive effects of increasing the role of interest rates in resource allocation are most welcome, but we agree with the authorities that maintaining the credit ceilings on individual banks and subjecting enterprises to hard budget constraints are still necessary to exercise effective monetary control at this early stage of the financial reform.

Finally, I have a few words on external assistance. Owing to its heavy burden of external debt and its large trade imbalances that cannot be improved before the medium term, Albania will need exceptional financial assistance over the next several years. Given the poor condition of the economy and widespread poverty, the large amounts of financing needed to maintain external viability should take the form of grants and concessional assistance from the international community. Albania's early normalization of relations with its creditors is essential to obtain this assistance, and we urge the authorities to speed up the process of settling their arrears and starting negotiations on debt rescheduling with commercial banks and bilateral creditors.

With these remarks, I support the proposed decision.

The staff representative from the European I Department remarked that, under the medium-term program currently being discussed with the authorities, one of the key financial objectives would be to eliminate the monetary financing of the budget deficit during the three-year program period. Eliminating that financing, by 1996, would bring the deficit to a level that could be financed by foreign support and by perhaps 1 or 2 percent of GDP of domestic nonbanking finance, if the necessary instruments could be developed.

The shortfall in net lending in the budget was the result of procedural delays in the disbursement of financing from a World Bank critical imports loan, which was shown in the budget as a receipt above the line to finance critical imports for enterprises, the staff representative said. With respect to applying Albania's fiscal gradualism to other economies in transition, the staff felt that Albania was a special case that probably could not be emulated. First, the initial conditions for Albania had been much worse than those of other countries. Furthermore, the external support that Albania received relative to its geographical size was significantly larger than that received by other countries in the region. Finally, the small demands for bank credit by enterprises from the slowly emerging private sector and the banking system's own inefficiencies currently left room for large fiscal credit demands without crowding out other sectors.

Using the experience of other countries in the region, Romania, for example, the only credible means the Albanian authorities had to impose discipline on enterprises was not granting them a full government bailout--in other words, penalizing them explicitly for past poor loan decisions, the staff representative commented. It was true that, as that method had imposed significant and, in certain cases, excessive hardship on certain credit or enterprises, the Government had decided to grant relief on a case-by-case basis, according to certain criteria and conditions. In any event, the authorities' overall resource constraint owing to the financial program made a full bailout impossible. The netting of arrears had reduced the gross arrears position from more than lek 13 billion to about lek 5 billion, which should also limit the net burden on enterprises.

The effort to address enterprise arrears had not been carried out at the start of the program, the staff representative from the European I Department continued, because enormous, radical changes had been implemented: the reversal of the 80 percent wage payments in June 1992, the introduction of the first enterprise wage policy, and the cutoff from unchecked credit and budgetary support. Those were the first steps in a gradual process. Arrears only became a problem as enterprises reacted to the hardened budget constraint by accumulating interenterprise arrears.

The staff representative from the Policy Development and Review Department considered that, under its present stand-by arrangement, Albania was establishing a very good track record that was the foundation for entering into a medium-term program. An ESAF arrangement would be appropriate, because of the obvious need for an emphasis on structural issues and because of Albania's need for financing at below-market terms. Negotiations

had already started on such an arrangement. Whether that would be in place when the present stand-by arrangement was concluded remained to be seen, but at present negotiations were going well. It would even be appropriate, given the cost of the stand-by arrangement, if the ESAF arrangement could come into place before the stand-by arrangement was fully concluded; in other words, replacing some of the expensive stand-by funds with the below-market funding of the ESAF. However, that remained to be seen.

As to whether the gradual fiscal approach in Albania was reproducible elsewhere, the staff representative said, he wondered whether it was really gradual. Looking at the numbers for total financing, in 1991 financing by the public sector was 44 percent of GNP, in 1992 it was 22 percent, and in 1993 it was projected to be 13 percent, excluding the 9 percentage points of items that had not been incorporated in earlier budgets. Those figures did not seem to be typical of a gradualist approach to fiscal adjustment.

Nevertheless, the fiscal gap in 1993 was projected to be sizable, the staff representative noted. That gap was sustainable because of the level of foreign financing. In Albania there was a direct link between balance of payments financing and fiscal financing. The country had had one of the most highly centralized systems in that part of the world and was still adapting. Albania had been greatly dependent on external support under the previous system. Since that support had been cut back substantially, there had been a precipitous drop in real output and real income.

Although fiscal requirements continued to be either 13 or 20 percent of GDP, depending on whether the 9 percentage points of items that were excluded from earlier budgets were included in the current one, they were still "financeable" because the foreign financing available was at below-market terms, the staff representative continued. Much of the foreign assistance had been in the form of commodity and food aid. The next program in Albania would have to emphasize structural reforms to permit the phasing out of such assistance. A major part of the structural reform effort was aimed at expanding the agricultural sector to make the country more self-sufficient. That effort was going well.

The sustainability of the Albanian adjustment path would critically depend on the pace of structural reform. That was expected to be a key issue in the discussions for an ESAF arrangement.

Mr. Törnqvist made the following statement:

When the program for Albania was adopted by the Board last August, this chair was among those stressing the serious downside risks, to which Mr Esdar has referred. It is all the more heartening to read in the staff report, as well as in Mr. Lanciotti's statement, about the significant achievements Albania has made halfway through the program. The authorities have managed to resist pressures to relax their adjustment policies and seem set to continue this course during the remainder of

the program period. One welcome result of the prudent policies followed has been a distinct drop in the monthly inflation rate.

As I agree with the staff appraisal, as well as with most of what has been said by previous speakers, I will only make a few comments for emphasis. Even if inflation has come down sharply, it is still very high, and it should be a matter of priority for the authorities to bring it down further. In this respect, incomes policy plays a crucial role. One may detect in the report that the authorities' resolve to maintain a tight incomes policy may be weaker than their commitment to other elements of the program. This is understandable, given the difficult social situation, and it will, indeed, be extremely difficult to hold the political and social consensus of reform together, resisting wage increase demands. This may be particularly true in the state enterprise sector, where a wage freeze is attempted. Nevertheless, I wish to support the staff in stressing how important it is for the success of the program that the authorities hold the line in this area.

On this same note, it is also essential that the fiscal stance be kept, although the budget will come under pressure. Further action will also be needed, as several speakers have already noted. I hope that the slower than programmed revenue collection that was discerned during the first months this year will turn out to be transitory.

The authorities have moved commendably quickly to address the issue of interenterprise arrears and that of nonperforming bank loans, and they have laid out a course of action for the coming months to resolve these issues. I fully agree with the emphasis put in the report on not losing momentum and proceeding to the more fundamental reforms on privatization and restructuring that need to be taken in the enterprise and financial sector in very close collaboration with the World Bank.

Price and exchange system liberalization has been substantial and welcome. I note that the authorities have requested admittance to the GATT to obtain early most-favored-nation and generalized system of preferences status for Albania. Early approval should help the export recovery.

On external financing, the picture remains mixed. Even though the remaining financing requirement for the present stand-by arrangement obviously can be met on the basis of existing commitments, financing gaps remain uncomfortably large in the medium term, and Albania's debt problem is looming. We welcome the prospects of a comprehensive review of these and other medium-term issues in the context of the preparations under way for a possible successor ESAF arrangement, something for which

Albania should be well placed if it continues as it has started out.

In this context, I noted with interest that some private activities appear to have been fueled in part by sizable private transfers from abroad. Can the staff say something about the origin of these transfers and whether they are likely to continue?

I can support the proposed decision.

Mr. Thorne made the following statement:

Let me start by congratulating the authorities on their strong performance so far under the stand-by arrangement. It is early into the arrangement, but I agree with other speakers that so far things are very much on course. It is in that context that I make my comments.

I wish to make a point on a fiscal matter, which might be considered technical but is nevertheless important. This relates to the end-December performance criterion for bank credit to the Central Government. The staff says that all the end-December criteria were met, but Table 3 on page 16 of the staff paper shows that this criterion for bank credit to the Central Government was only met by excluding bonds issued to banks to write off nonperforming loans. In the very full description in the original stand-by arrangement of the circumstances in which the criteria could be adjusted, this exclusion was not mentioned. I think it is a well-justified exclusion, but technically I believe that the end-December credit should have been reported as lek 5.9 billion, that is, above the target, and a waiver sought. For transparency's sake, it is important that performance criteria be measured as originally defined, a point this chair made recently in the case of Lesotho. Needless to say, I would have had no difficulty in granting a waiver.

I see that this adjustment factor for bonds has been included in the description of the newly set performance criteria on page 47 of the staff paper and I welcome the intention to adjust the credit limit downward for any shortfalls in domestically financed investment and enterprise support disbursements. This is a very helpful innovation to ensure that unexpected savings in some areas of the budget are not used to accommodate overspending elsewhere. It could, perhaps, be applied in other countries' programs as well.

As far as enterprise reform is concerned, I welcome the newly introduced bankruptcy law and look forward to the World Bank's EFSAL. The staff paper says relatively little about privatization, but I agree with the staff that it is important to extend

efforts here beyond small firms and property as described in the authorities' letter. Development of a strategy for privatizing larger firms seems to be taking longer than first expected.

The progress in filling financing gaps has been broadly acceptable to date, especially as the reserves accumulation now projected for 1992 and 1993 is \$51 million higher than previously projected, although it is regrettable that bureaucratic delays have slowed G-24 disbursements. I join the staff and other speakers in urging progress in reaching a settlement on commercial debt.

In conclusion, let me repeat my overall commendation of the authorities on the vigorous start they have made in the long process of reform. If this can be sustained, then I would welcome the successor ESAF program as suggested by the staff.

Mr. Verjbitski made the following statement:

Albania's economic adjustment over the first six-month period under the stand-by arrangement with the Fund has been very impressive. The authorities' firm commitment to reform based on the broad political and social consensus in the country has been, undoubtedly, the key to this initial success.

I fully agree with Mr. Lanciotti's view expressed in his statement that the Government should be commended for the first significant results under the program of macroeconomic stabilization and structural reforms in Albania, and especially for thus far having courageously resisted the mounting pressures from the public enterprise sector with regard to alleviating the burden of interenterprise arrears through a financial bailout by the state.

Now that the sharp decline of output appears to have been arrested, the rate of inflation has been brought down from 12 percent to 4 percent per month, and gross official reserves have increased to the equivalent of seven weeks of imports, the authorities' program objectives for 1993 are already well within reach.

The most crucial thing for the Albanian authorities to do at this point is, in my authorities' view, to maintain the momentum of their reform effort and persevere vigorously with market-oriented structural reforms and privatization. In this context, it is very important to complement the current policy measures with an early comprehensive medium-term program of adjustment that could be supported by an ESAF arrangement with the Fund.

This chair shares the Albanian authorities' view, unequivocally supported by the Fund staff in its excellent report, that substantial and continued international support for Albania's

transition to a market-based economy is of paramount importance. It is very unfortunate that, during the second half of 1992, when unemployment in Albania reached an estimated 26 percent of the labor force and wages declined by about 30 percent in real terms, there were delays in food aid shipments and significant shortfalls and delays in medium- and long-term external financing by the EC, G-24 countries, and the World Bank. The explanation that these delays, as the staff paper notes, "were caused mainly by procedural problems" is, in my opinion, clear evidence of inefficiencies in the existing mechanisms for mobilizing international support for the Fund-approved adjustment programs.

My authorities believe that the daunting tasks facing the formerly centrally planned economies in the course of transition to market economies and the great stake that the international community has in their success merit a more responsive and flexible collective approach to assisting these countries.

At this stage of the discussion, as I support the bulk of the recommendations of the staff and the proposed decision, I would like to conclude my brief remarks by emphasizing one more key element contributing to Albania's rapid progress in attaining a certain degree of macroeconomic stability: a responsible and prudent credit policy involves close cooperation between the Government and the central bank. Such a policy does require that, at some point, real interest rates established by the State Bank of Albania should be brought up from currently negative levels to positive levels. This would be necessary to assure a sustainable inflow of private capital from abroad and prevent capital flight in the future.

Mr. Shaalan made the following statement:

Despite exceptionally difficult starting conditions and the fundamental nature of policy changes, important progress has been made under Albania's program to restructure its economy. This progress is well documented in the staff report before us today. In particular, I am pleased to note the success in arresting the sharp decline in output and the marked recent fall in inflation. The authorities are to be highly commended for their perseverance in what I am sure is a difficult adjustment effort. I will focus most of my comments on the issue of public enterprise arrears.

I share the staff's assessment that the positive results achieved thus far are fragile in view of the many risks that continue to affect the economy. Most worrisome in this regard are the difficulties in enforcing financial discipline of state-owned enterprises and the risk to the financial program. Even though the financial difficulties of enterprises are deeply rooted in the legacy of the past, measures need to be taken, first, to contain

future arrears and, second, to address the underlying causes of the problem.

On the former point, the immediate abolition of certain banking practices that facilitate the accumulation of arrears and the quick progress in enterprise restructuring, such as requiring enterprises to operate on a commercial basis and improving enterprise governance, are essential to safeguard the financial parameters of the program. The recent measures taken by the authorities are welcome in this regard. They seem to have succeeded in virtually arresting new interenterprise arrears. I would caution that there is a need to closely monitor wage policy for enterprises as further increases in wage ceilings during the program period may jeopardize the adjustment effort.

On addressing the underlying causes of these enterprise arrears, which I believe should be seen in a longer time perspective and perhaps as an integral component of a possible successor arrangement, action should be taken to close enterprises that cannot survive in the new market environment, and partially or fully privatize many of the enterprises. These steps should be part of a menu designed to establish an economic system based on private property and free individual initiative with the necessary legal and institutional framework and the commercial codes to encourage private investment. I share the staff's view that Albania is now reaching a more complex stage of structural change. Accordingly, it is necessary to keep these reforms "appropriately focused and sequenced."

Let me conclude by seeking more information from the staff on the status of the mining sector, given its potential as a mainstay of the economy, and the expected supply response of the agricultural sector in 1993 to the considerable progress made in land reform, which has proceeded at a much faster pace than in other Eastern European countries. I would note that, given the dramatic fall in output over the past few years, popular acceptance of the adjustment efforts hinges to a large degree on not only stopping the free-fall of economic activity, but also on quickly reversing this situation.

With these comments, I support the proposed decision.

Mr. Mojarrad made the following statement:

The staff report, as well as Mr. Lanciotti's helpful statement, provides a clear assessment of the economic achievement in Albania under the first program supported by the current stand-by arrangement. The Albanian authorities deserve to be commended for undertaking decisive steps toward a market-oriented economy and making significant progress in financial policy implementation and structural reforms during a rather short period of time.

Especially noteworthy are the authorities' efforts in price and exchange system liberalization and in building the key institutional and legislative framework for a market economy, and their continued commitment to adhere to the overall policy objectives of the 1992-93 program, as well as their desire to undertake a comprehensive medium-term program. Nonetheless, in the present difficulties in the enterprise sector and worsening social conditions stemming from rapidly growing unemployment and declining living standards, we are concerned that failure to assume tighter demand policies and maintain the momentum of key structural reforms may undermine the gains made thus far. We are, moreover, concerned about the adverse impact of further delays in, and shortfalls of, external support experienced in 1992 on the authorities' adjustment efforts, and we hope that disbursements of the committed aid are made in a timely fashion this year. At the same time, an early and more vigorous resolution of the external debt problem is a step in the right direction for the attainment of external viability. As indicated by the staff, Albania would need a large amount of concessional financial support from the international community. In this regard, we would welcome the Board's consideration of the Albanian request for an ESAF arrangement following the termination of the current stand-by arrangement. We are in broad agreement with the staff appraisal and recommendations and support the proposed decision.

The staff representative from the European I Department remarked that the main source of remittances and transfers was largely Albanian workers in neighboring countries, such as Greece and Italy, and, to a lesser degree, other Albanians living abroad. The purpose and form of those flows were twofold. Those flows were partly in kind in the form of imported consumer durables and also provided funds for small-scale investment projects, such as coffee shops, and other small businesses, as well as private housing construction. As to whether the remittances and transfers were sustainable, that depended on the implementation of a sound financial program that would encourage those flows to formally enter the country through a more efficient banking system. At present, only a small fraction of the flows came through the banking system.

When the stand-by arrangement was designed in the middle of 1992, although it was foreseen that the replacement of bad loans in the bank portfolios would be necessary either later in 1992 or the early part of 1993, the amount and the exact timing were not known, the staff representative said. Therefore, the government bonds involved were not explicitly included in the budget for the second half of 1992. Furthermore, the staff had viewed the operation largely as a below-the-line financing transaction. As a result of that transaction being excluded from the budget plan, there had been no allowance for it under the credit ceiling for the budget. Therefore, the staff felt that it would not have been consistent ex post to treat the operation as a violation of the relevant performance criterion. However, the staff agreed that, technically, it would have been

clearer and more transparent to ex ante explicitly exclude the operation from the performance criterion, as was being done at present for the second half of the program.

The principal traditional mining minerals in Albania were chrome, iron, nickel, copper, and coal, along with a number of other minor products, the staff representative noted. In addition, at present, petroleum onshore extraction covered domestic consumption, and significant offshore deposits were starting to be explored under five production-sharing agreements with foreign companies that had been concluded in 1992.

As to prospects for developing the mining sector, of the four major minerals, chrome clearly had the greatest potential, although production had fallen by more than half during the crisis of the late 1980s, the staff representative continued. In order to recover, the authorities and technicians in the field estimated that the immediate investment requirements needed were at least \$75 million, with additional medium-term investment requirements of \$50 to \$100 million. Significant technical assistance was being provided by the World Bank and the EBRD to design a mining strategy for chrome and help the authorities negotiate with potential foreign partners that would be the major providers of funds. The key elements for the strategy would include a transparent legal regime, a mining law, and a transparent fiscal regime. In 1992, the authorities' desire to avoid an undue concentration in the world chrome market was the reason that, despite good prospects for investment in chrome with a foreign partner, they had decided not to do so. Although interests in investing in chrome existed, nothing concrete had materialized at present.

With respect to the other three minerals, copper, iron and nickel, they had also been affected by the mining crisis, although the underlying, fundamental problems in those sectors were much more severe than those of chrome, the staff representative noted. According to the latest calculations, of those minerals, copper was the only viable one for extraction, and only barely so, in the medium term, again with substantial foreign investment. Iron, nickel and coal had rather dim prospects for viability and profitability.

As to the prospects for recovery in the agricultural sector, it was too early in the year to make a precise forecast, the staff representative from the European I Department remarked. The stand-by arrangement assumed a significant recovery of approximately 10 percent in real terms, comparable to the previous year. The winter harvest appeared to be going well, particularly in the production of wheat for which the Government had already announced in the fall that there would be a higher producer price. The European Community checked the progress of the harvest almost every month in order to coordinate the provision of food aid, and it expected that by May or June of this year, its staff would have a better estimate of the actual agricultural crop.

Mr. Thorne asked what interest had been shown in investing in tourism. In addition, he pointed out that the circumstances described by the staff of

an unexpected but benign call on bank credit were ideal ones for the Board to grant a waiver, rather than the staff making adjustments to the figures with a footnote in the staff paper.

The staff representative from the European I Department said that the authorities were in the final phases of designing a tourism strategy with the assistance of the European Bank for Reconstruction and Development (EBRD). That strategy would be the basis for negotiating contracts with foreign investors who had already indicated their interest in the southern coast--which had a very good potential for tourism, although on a small scale--organized tours to Albania, and urban tourism. Organized tours and urban tourism would require operators and large foreign investment. There had been significant interest shown in investment in major hotels in the cities. The negotiations on two contracts for hotels in Tirana had already been concluded. For all areas, significant tourism investment requirements were substantial, as Albania's tourism sector was largely undeveloped by Western standards.

The staff felt that it would have been inconsistent ex post to have the authorities violate a performance criterion under the stand-by arrangement because of an operation that they had already known about and agreed upon prior to the arrangement and actually was a significant advance in the reform effort, the staff representative remarked.

Mr. Lanciotti said the road that Albania had to follow in order to rebuild and transform its dilapidated economy was clear, but full of risks and difficulties. The support that Albania had received at that critical phase of the transition process provided a stimulus to the Albanian Government to continue to persevere in its strong and comprehensive reform program.

The Chairman agreed that Albania had really been an exceptional, difficult, but exciting case for the international community and for the Fund to support.

The Executive Board took the following decision:

1. Albania has consulted with the Fund in accordance with paragraph 4(b) and (c) of the stand-by arrangement for Albania (EBS/92/121, Sup. 2) and the third paragraph of the letter from the President of the Republic of Albania dated August 2, 1992.

2. The letter of the President of the Republic of Albania dated March 1, 1993 with annexed Memorandum shall be attached to the stand-by arrangement, and the letter of August 2, 1992 with annexed Memorandum shall be read as supplemented and modified by the letter of March 1, 1993.

3. Accordingly:

(a) the performance criteria set forth in paragraph 4(a)(1) to (7) of the arrangement shall be as specified in Appendices I to VI of the Memorandum annexed to the letter of March 1, 1993, and

(b) the following subparagraph (a)(8) shall be added in paragraph 4 of the arrangement:

"the targets on the gross foreign assets of the Bank of Albania for end-March and end-June 1993 referred to in the last paragraph of Appendix I of the Memorandum".

Decision No. 10325-(93/42), adopted
March 31, 1993

2. BURKINA FASO - 1992 ARTICLE IV CONSULTATION, AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1992 Article IV consultation with Burkina Faso (EBS/93/35, 3/9/93) and Burkina Faso's request for arrangements under the enhanced structural adjustment facility (EBD/93/39, 3/11/93). They also had before them a background paper on recent economic developments in Burkina Faso (SM/93/64, 3/24/93).

The staff representative from the African Department noted that all the necessary prior actions, which were summarized in Table 1 of the staff report, including the issuance of the supplementary budget, had been taken before end-March. Most of the final data on the quantitative benchmarks were not yet available, with the exception of a transfer from the price equalization agency (CGP) to the Treasury of CFAF 5 billion that the Government confirmed had taken place. The structural benchmarks had been observed, as well as the measures that were neither prior actions nor benchmarks, but were in the policy matrix, according to the information that the staff had received from the authorities.

The financing gap had been reduced with CFAF 31.8 billion from the Fund and the Bank, the staff representative continued. Reasonable assurances had been received for a further amount of CFAF 27.3 billion, two thirds of which would be financed by France and the European Community. The remaining gap of CFAF 4.5 billion was expected to be closed with debt rescheduling from the Paris Club. That amount did not include the previously rescheduled debt under the Toronto terms.

Mr. Santos made the following statement:

My Burkinabè authorities would like to express their appreciation to management and the staff for the constructive discussions held in connection with the 1992 Article IV

consultation and for the assistance provided in the formulation of their adjustment program for 1993-95. They have no major difficulty with the thrust of the staff appraisal and policy recommendations.

In view of the authorities' stated commitment to reinforce the internal adjustment in the framework of the West African Monetary Union (WAMU), they have reformulated their economic policies and adopted a medium-term strategy centered on the effective control and rationalization of the public finances and on the resolute implementation of structural reforms affecting major sectors of the economy. Underlying the authorities' strategy is their commitment to reduce the public sector's claim on available resources, achieve a durable improvement in competitiveness, promote private sector activities through adequate incentives, and enhance the growth potential of the economy.

Consistent with this adjustment strategy, the program for 1993-95 under the ESAF aims at achieving real GDP growth of 3-4 percent per annum on average over the period, containing the rate of inflation below 2.5 percent annually, and reducing the external current account deficit, excluding official transfers, to 13.7 percent of GDP by 1995 from 15.4 percent of GDP in 1992. Reflecting the strong emphasis on fiscal consolidation, the overall fiscal deficit, on a payment order basis and excluding grants, is expected to be more than halved to 2.8 percent of GDP in 1995 from an estimated deficit of 6.1 percent of GDP in 1992.

To consolidate the important progress made under the first annual structural adjustment arrangement and correct the fiscal deviations that occurred in 1992--a year when economic management was overtaken by the heavy political agenda--the authorities have embarked upon an ambitious structural reform program and have implemented a set of wide-ranging measures to contain expenditure and raise revenue. The significant increase in revenue contemplated under the 1993 program is predicated on the improved income elasticity of the tax system stemming from the important tax reform that has been launched with the 1993 budget. The reform of the tax system aims at broadening the tax base, simplifying and rationalizing the rate structure, and strengthening tax collection. In the context of the tax reform, a value-added tax replacing the more complex turnover tax, "taxes sur le chiffre d'affaires" (TCA), and a new system of taxation of the informal sector were put into effect January 1, 1993. Also included in the 1993 budget is a new and simplified tariff schedule with fewer rates and a reduced average rate. Furthermore, the establishment of a surveillance firm, the elimination of most exemptions, and the extensive use of tax withholding at the source should go a long way in increasing the efficiency of the tax administration.

Notwithstanding these measures, the fiscal position is expected to deteriorate by 2.3 percentage points of GDP in 1993 as a result of some exceptional and nonrecurring factors that bear heavily on government expenditure. Nonetheless, despite these negative factors, the fiscal adjustment during the current year is impressive, as illustrated in Table 1 on page 7 of the staff report, which puts the magnitude of the underlying fiscal adjustment into the proper perspective. Indeed, as shown in this table, without the compensatory measures implemented by the authorities, the overall budget deficit would have increased by about 8 percentage points of GDP in 1993. It should be emphasized that, in addition to partially offsetting the impact of the exceptional factors on the deficit, most of the measures introduced in the 1993 budget and those under consideration for inclusion in the 1994 budget are expected to bring about a durable improvement in the fiscal position over the medium term. For example, the politically sensitive decision to reduce the wage scales by 10 percent across the board not only yields savings amounting to CFAF 2.2 billion in the wage bill for 1993, but will also bring about a considerable slowdown in the bill's growth over the medium term.

Foremost among the exceptional factors affecting government expenditure in 1993 are the costs of the rehabilitation of the cotton sector and the restructuring of the banking sector. In view of the large potential benefits to the economy that could result from an improvement in the functioning of these two sectors, the authorities strongly believe that their reforms should be carried out as a matter of priority. Regarding the cotton sector, following the reduction in producer prices enacted during the 1992-93 season, the main concern of the authorities was to strike a balance between the need for further price reduction to ensure price competitiveness and the need to maintain adequate incentives to producers to boost production. To complement the price adjustment, it is the intention of the authorities to provide extension services promoting modern production techniques in order to lower costs in this sector. As far as the banking system is concerned, the authorities have decided to accelerate the privatization of the banks experiencing difficulties and consolidate their capital to meet the required prudential ratios with the overall objective of enhancing financial intermediation in the country.

In their efforts to increase private sector involvement in economic activities, the authorities are taking steps to improve the regulatory and legal environment and facilitate the accession of local businessmen to ownership of the capital of public enterprises selected for privatization. It is worth noting that a new labor code introducing more flexibility into the labor market has been passed by Parliament, and that the mining legislation as well as the commercial code are being revised. The Privatization

Commission established to oversee the privatization process has become operational, with three enterprises already effectively turned over to the private sector. Bids have been received for eight other enterprises, and the selection process is well under way. Barring unforeseen difficulties in the negotiations, the objective of privatizing 12 enterprises by end-1993 should be met.

To conclude, since the establishment of a pluralistic system of government, my Burkinabè authorities have taken difficult measures in a number of sensitive areas that are aimed at deepening the economic reform process. Even though they are strongly committed to carrying through these reforms, they are aware that the decision-making process in the new political setting may prove lengthy at times because of the need to ensure broad popular support. A difficult balance should be struck between conflicting objectives and claims from the population. The authorities remain confident that the international community will continue to support their efforts and help cushion the impact of the adjustment process on the most vulnerable segments of the population.

Mrs. Martel made the following statement:

Let me start by indicating that I broadly share the staff's assessment of the economic and financial situation of Burkina Faso and its prospects for the coming years.

Since 1991, Burkina Faso has been engaged in an in-depth transformation of its economy, and, it is fair to say, the authorities' determination to forcefully pursue the adjustment process is based on a solid and broad consensus that the Government has been striving to build since 1989. Indeed, such a commitment to reform was demonstrated by the considerable progress made during the first year of the structural adjustment arrangement on both macroeconomic and structural fronts.

The political agenda diverted the authorities' attention somewhat from the reform process in 1992, but, overall, slippages were limited--1.3 percent of GDP--as the Government took courageous measures, namely, on the wage bill, to keep the fiscal deficit in check.

The ESAF-supported program clearly reflects the authorities' intention to accelerate the reform process, especially in the two areas that form the basis of their domestic adjustment strategy--the implementation of tight controls on public finances and reduction of the Government's involvement in the economy.

I would first like to make a general remark on the program. From the outset, I was impressed by the front-loading of reforms

in the program for 1993. The long list of measures indicated in Table 3 of the staff report reflects the authorities' preparedness to move forcefully, but it raises the question of whether such a pace of reforms is sustainable by the public administration. The strong prior actions already adopted and the benchmarks achieved by end-March 1993, as the staff has just mentioned, prove the authorities' determination to gain momentum on the various reforms, but, as noted in the staff report, particular attention will have to be given to the sequencing of these reforms. Moreover, the Administration's implementation capacity will probably have to be strengthened by well-targeted technical assistance, and I welcome, in this regard, the planned public institutional development project that, with the support of the World Bank, focuses on the public administration's capacity for building and reorganization.

With regard to public finances, it should be noted that the 1993 budget is the first one adopted by a fully democratically elected assembly. Therefore, the measures adopted to contain the wage bill, namely, the decisions to forgo wage arrears and reduce wage scales by 10 percent, are highly commendable. Such decisions, coupled with the past freeze on wages and the agreed replacement of automatic step increases by selective promotion based on merit, should allow for a downsizing of the wage bill in real terms from 8.2 percent of GDP in 1990 to 5.6 percent in 1995.

On the revenue side, equally decisive and courageous measures have been implemented in an up-front manner in the budget with a comprehensive tax reform, a full restructuring of the customs tariff, and the establishment of a mechanism to tax the informal sector.

The projected increase in revenue in 1993 of 21 percent from the previous year is ambitious, although the targeted level of revenue of 14 percent of GDP was attained in 1991, which was a normal year. Nevertheless, to reach such an objective the collection effort will have to be strengthened, at the same time ensuring an orderly implementation of the new tax and customs reforms.

In this regard, particular attention should be paid to the impact of the customs tariff reform on the cotton sector in the framework of the ongoing restructuring. In this respect, the work regarding the taxation of the cotton sector could benefit from a broader approach that included all the West African countries involved.

In the same vein, I agree with the staff's emphasis on the early adoption of a more simplified value-added tax system along the lines recommended in the proposal for tax harmonization that is being prepared by WAMU.

In the area of structural reforms, measures adopted since 1991 have gone a long way toward transforming the economy. Import restrictions have been phased out, administrative procedures simplified, monopolies on most imports and exports eliminated, price controls phased down, and a new investment code adopted. This liberalization process, as the staff has rightly pointed out, must be completed, nevertheless, to further improve the allocation of resources.

As the authorities' strategy for future growth, particularly the development of investments, relies strongly on the private sector's response, it will also be critical that the reforms of the public enterprise and banking sectors be implemented in a timely manner.

As regards the latter, there is a pressing need to finalize the restructuring process of the commercial banks in order to avoid the emergence of additional costs to the Government and to establish a sound banking sector, at the earliest stage possible, that will fully play its intermediation role.

Moreover, the disappointing results in the recovery of nonperforming loans call for a renewed effort by the collection agency (BRCE) in 1993. The authorities' intention to grant BRCE strengthened collection authority is, in this regard, encouraging.

Turning now to the external sector, the authorities' stance on strict demand-management policies will be instrumental in strengthening the external position. Exports will, however, remain very sensitive to exogenous factors, such as weather conditions and developments in world cotton prices. In 1992, faced with a projected 4 percent loss in the terms of trade, mainly in cotton export prices, the authorities made a courageous decision to reduce producer prices. Productivity enhancement and efficiency gains that the authorities are seeking through the ongoing agriculture sectoral adjustment program will, in this context, play a major role in improving export profitability and ensuring sufficient income generation in the rural sector.

Together with the move toward trade liberalization, private sector participation in the economy, and the authorities' emphasis on regional integration, the overall package of reforms contemplated for this program period represents, in my view, a comprehensive and credible strategy to sustain growth over the medium term. My authorities are therefore prepared to help Burkina Faso carry out its adjustment efforts, namely, by contributing to its exceptional financing needs. They would, in this regard, give favorable consideration to a highly concessional treatment of Burkina Faso's debt under the aegis of the Paris Club.

To conclude, I welcome the decisive support, both technical and financial, provided by the Fund and can approve the proposed decision.

Mr. Hammoudi made the following statement:

After having observed all the performance criteria in 1991, the authorities have encountered some difficulties in 1992. However, it is important to point out that a natural calamity and exogenous factors beyond the authorities' control were mostly responsible for the nonobservance of some of the performance criteria. Indeed, drought, the drop in the world cotton prices and workers' remittances, as well as political changes have hampered the authorities' adjustment efforts in 1992. Consequently, the financial imbalances have worsened with the deterioration of fiscal and external current account deficits. Although the inflation rate was low, the difficult financial situation has delayed the implementation of some structural reforms, particularly in the cotton and banking sectors.

We are pleased to note that the newly elected Government is committed to the economic adjustment process, and we support its request for arrangements under the ESAF. The strategy chosen in order to overcome the financial difficulties and restructure the economy seems appropriate. Whereas on the macroeconomic side the authorities have to be concerned with appropriate fiscal and monetary policies, on the structural front a wide range of measures are needed to put an end to distortions that have hampered growth and development.

As regards the fiscal sector, the urgent task is to reduce the deficit by curbing unnecessary expenditures and placing strict control on spending, as well as implementing tax reform. We welcome the decisions that have been taken in this area, in particular the reduction of the wage bill and subsidies on goods and services, in addition to the simplification of the tax system and the limitation on exemptions. Given the size of the fiscal deficit, we believe, however, that further progress is needed. It is advisable to continue streamlining expenditures and carrying out transparency procedures in the budget. At the same time, efficient management should be introduced in the tax administration so as to improve revenue collection. Given the size of the arrears and the underlying difficulties caused by this problem, it is important, however, that the authorities be allowed sufficient flexibility to progressively phase out the fiscal deficit. Could the staff elaborate more on this issue, and also on the link between the erosion of the tax base and the contraction of export earnings, as stated in the third paragraph on page 3 of the staff report?

With respect to the monetary sector, until recently, credit to the Government was given greater importance than the productive sector; thus, this sector has been crowded out. It is necessary that the trend be reversed. For the economy to recover, the productive sector, particularly the private sector, should have greater access to sufficient financial resources. In this regard, market instruments should serve as tools for the efficient allocation of resources. On a related matter, we welcome the decisions taken to strengthen supervision and control over the banks as well as the provision of more effective prudential procedures.

Concerning structural policies, the authorities have already embarked on a wide range of reforms, but their efforts have been stalled by a lack of financial resources and a proper legal framework. It is encouraging to note, however, that they are committed to pursuing the implementation of reforms in the public enterprises, the labor sector, and the banking system.

In addition, laws have been adopted for investment and commercial activities, and decisions have been taken to simplify the administration of the tax system, broaden its base, reduce its rates, and limit its exemptions. We also note that the authorities intend to initiate a civil service reform in cooperation with the World Bank. Moreover, as stated in Mr. Santos's comprehensive statement, the privatization of enterprises, especially in the cotton and banking sectors, is high on the authorities' agenda. This process needs to be accelerated in order to generate more revenues to improve the public finance situation. In this regard, the international financial community should assist Burkina Faso financially and technically in order to complete its privatization program. As to the merger envisaged between the savings institutions and financial postal services, Comptes Chèques Postaux (CCP), we do not see any benefit in such an undertaking, given the different purposes and nature of the institutions. Indeed, the simplicity of regulations and the unique benefits of the CCP to workers and small businesses are among their strong features. Furthermore, the saving function could be easily integrated into, and relegated to, the banks while they are being restructured. It is possible that the cooperation between the institutions could be accomplished without a merger, as is the case in many other countries. The staff's comments would be appreciated.

Turning to the external sector, given the fact that the country is dependent on one product, cotton, which is a price-taker in the world market, Burkina Faso is vulnerable to adverse external shocks, in addition to the weather problem. In this context, although building foreign reserves is helpful in the short run, it is the diversification of the economy that could, in the long run, protect the country from external shocks. In this

regard, we commend the authorities for diversifying--with the cooperation of the World Bank--the agricultural sector, and promoting mining, tourism, and handicraft activities, as well as strengthening the role of the private sector toward export activities. Incidentally, it is encouraging to note that the involvement of the people in development operations has achieved more efficiency and greater success, as has been witnessed by many nongovernmental organizations and the media in Burkina Faso. In this regard, we will be interested to hear from the staff about Burkina Faso's experience.

To conclude, we believe that the success of the economic program under discussion depends, to a great extent, on debt relief with concessional terms and financial assistance from the international community in a timely manner. We support the proposed decision.

Mrs. Hansen made the following statement:

Burkina Faso performed well under its first-year structural adjustment arrangement, achieving the program's quantitative targets and making good progress on structural reform. We recognize that the transition to constitutional rule absorbed most of the authorities' attention in 1992, and we hope that, now that the democratization process is well under way, the authorities can direct their energy toward the equally important task of economic adjustment.

In our view, the proposed program is a strong one that places appropriately strong emphasis on structural adjustment. We particularly welcome the emphasis on fiscal reform, bank rehabilitation, and privatization and reform in the cotton sector. I would like to touch briefly on these issues.

With regard to the fiscal situation, we regret that the fiscal deficit is as large as it is in 1993, but we recognize that a good part of the deterioration is attributable to special factors, such as restructuring costs and a laudable effort to increase transparency by bringing previously off-budget transactions into the regular budget. Moreover, we can see that the fiscal program involves a substantial degree of adjustment over the three-year ESAF period.

On the revenue side, the progress made thus far to increase tax revenue by broadening the tax base and improving collections of tax and customs duties is commendable. For the remainder of 1993, we welcome the authorities' intention to continue to make the tax system more transparent and effective by further simplifying the value-added tax and improving tax administration.

On the expenditure side, we share the authorities' and the staff's view that there is a continuing need to rebalance public spending to reflect development priorities. In this connection, we welcome the difficult and important measures that the authorities have taken to contain the civil service wage bill, such as moving to a merit-based pay system and reducing salary scales. Even though we welcome the fact that wages are expected to drop from the current level of some 53 percent of current expenditure to a 46-48 percent range over the ESAF period, we note that this is still a rather high level that necessarily crowds out other high priority spending. Therefore, we would urge the authorities to look for additional ways to reduce the wage bill over the medium term.

Similarly, although we commend the authorities' recent progress in reducing military expenditure to some 18.5 percent of current expenditure, we see room for considerably more action on this front. The case for further reductions seems all the more compelling when one considers that the defense spending accounts for about triple the amount of current expenditure on the critical agriculture sector and about twice the amount spent on health.

With regard to banking sector reform, we agree that the authorities should try to complete as much of the intended restructuring and privatization as soon as possible in order to stem the drain on government finances and establish the healthy financial intermediaries required for future private sector development. Throughout this process, we hope the authorities will bear in mind the critical importance of ensuring that banks make lending decisions according to normal commercial criteria so as to avoid a new accumulation of bad or doubtful loans.

Likewise, with respect to the cotton sector, we agree that the authorities are wise to spend resources now to increase productivity and competitiveness. Not only can the eventual efficiency gains help improve the country's external position, but they also limit domestic pressures for producer price subsidies. The issue of what is the appropriate level for producer prices is a complex one. However, we hope that the authorities will continue to reduce cotton producer subsidies, while seeking to diversify domestic production to the extent possible.

With regard to the external sector, we note that Burkina Faso has had a cumbersome regulatory and licensing system, which has been an impediment to investment and trade. We urge the authorities to continue to remove import barriers and streamline investment procedures in order to increase Burkina Faso's ability to attract new investment.

Finally, a word on the design of the program. As noted earlier, we appreciate its strong emphasis on structural reform and welcome the inclusion of several structural reform performance criteria. In our view, such structural reform criteria provide an important signal as to the importance the Fund attaches in ESAF programs to progress on structural reform.

We also take note of the fact that implementing the wide range of structural measures will sorely tax the country's administrative capacity. We hope that the authorities, the Fund, and the Bank will try to draw on whatever additional technical assistance might be required to ensure that this program will be implemented successfully.

The staff representative from the African Department said that the principal objectives of the customs duty reform, as part of the tax reform, were to improve the effectiveness of the customs system, increase its returns, and reduce fraud as much as possible, as well as limit the number of exemptions. Another objective of the customs reform was to maintain or improve competitiveness in the exporting sector. Part of the reform program was a so-called drawback system that permitted exporting companies to receive reimbursements on the taxes they had paid, including customs duties. The staff was working hard to help the authorities put that system in place; it had recently recruited a fiscal expert who would be going to Burkina Faso shortly and whose primary objective in the first month would be to set up an efficiently working drawback system. Therefore, the initial increase in costs as a result of the tax and customs reforms for export enterprises that had been exempted in the past would be covered once the drawback system was in effect.

The staff fully supported privatization of the banks, the staff representative continued. In order to have a well-functioning banking system with only a small degree of government interference, privatization had to be achieved early in the program. However, early privatization entailed high initial costs and front-loading, which helped to explain the large fiscal deficit anticipated in 1993.

Given the size of the deficit in 1993, there appeared to be a need for a greater tax effort, the staff representative added. However, in the context of arrangements with the Fund, the staff had to choose between the more short-term goal of generating sufficient revenue to keep the deficit in check or the longer-term objectives of preventing a flare-up of inflation and a deterioration in competitiveness and strengthening private sector activities, one of the principal structural objectives. The staff was afraid that if taxes were raised too much at the outset, in order to keep the deficit down, they would stifle private sector activities, which were a major part of the program. It was a difficult choice, but he hoped that an appropriate solution had been reached.

As international trade had retracted in 1992, the tax base had eroded, the staff representative said. In that context, the move toward a single

value-added tax rate of 15 percent in 1994 would provide a built-in increase in taxes.

Further reductions in the wage bill would be discussed during the staff's negotiations with the authorities, the staff representative said. Discussions by the Government with trade unions on wage developments were generally difficult because a delicate balancing act had to be performed between the short-term objective of cutting wages in a given year and the longer-term one of structurally improving the economy's wage system by replacing automatic advancement by a merit-based system. If the Government had pushed the unions too hard for concessions in 1993, the chances of obtaining that structural improvement would have been smaller.

The merger between the CCP and the savings institutions was indeed useful, the staff representative from the African Department remarked, because the two institutions were catering to different clientele. As part of the banking system reform, the merger was being implemented to broaden the banks' range of activities toward universal banking by allowing banks to carry out nontraditional operations. There were advantages in opening up the banking system, such as making it more responsive to emerging demand for banking services.

Mr. Prader made the following statement:

We would like to congratulate the Burkinabe authorities on the outcome of their discussions with the Fund and the World Bank, that is, together working out the road map for continuing and intensifying the economic restructuring begun in 1990-91. That this outcome could be achieved so rapidly after the completion, in the middle of 1992, of the democratization process with the installation of the new Government can only be interpreted as a sign of urgency and commitment on the part of the authorities.

With regard to the priorities of the restructuring program, we welcome the emphasis put on domestic adjustment, even though the staff seems to see this emphasis as a necessary consequence of the exchange rate constraint. In our view, domestic adjustment has strong merits in its own right, independently of currency arrangements, especially in countries with economic structures like that of Burkina Faso. Therefore, fostering competitiveness, liberalizing prices, and curbing fiscal spending will very likely go a long way in terms of enabling the authorities to reach the benchmarks set in the policy framework paper.

In the labor market, the planned switch from automatic step increases to a selective promotion system based on merit for public servants is a courageous step in the right direction, which, incidentally, could serve well as a model for most other countries, including industrialized ones.

Although Burkina Faso's ability to repay the Fund is relatively strong, as indicated by the projected increases in domestic output and exports, its level of foreign reserves, and its comparatively low external debt, it is worrisome that an unfavorable evolution of the world's cotton prices could have such a profound effect on the country's current account deficit or debt-service ratio. In this regard, could the staff please elaborate on what are the priorities to strengthen and diversify the agricultural sector hinted at in the staff report?

Finally, because of the exceptional financing requirements, especially in the initial stages of the program, and given the country's potential, the treatment of Burkina Faso should be comparable to that given to other low-income countries by the Paris Club creditors. This could produce an annual average reduction of debt-service payments of about CFAF 4 billion. We are happy to endorse the proposed decisions.

Mr. Esdar made the following statement:

After the disappointing performance under the past structural adjustment arrangement, I welcome the intention of the new Government of Burkina Faso to address the macroeconomic imbalances and structural rigidities under a new Fund-supported program, which, in my view, goes in the right direction. As formulated on page 5 of the staff report, the program is certainly ambitious but necessary in order to regain the momentum of the reform process. Therefore, I would like to urge the authorities to implement the agreed elements of the program.

I am in broad agreement with the staff's views and recommendations. With regard to the design of the program, I fully endorse Mrs. Hansen's remarks. Thus, I will limit myself to making some comments and asking a few questions.

Despite commendable efforts, the fiscal imbalance remains very significant. In the report, the staff has reminded us that a delicate balance must be maintained between reform and the need to generate the necessary political support. Perhaps the staff could explain how further reduction of the fiscal deficit and further cutting of the wage bill could be achieved without jeopardizing the public's cooperation.

Continuing with fiscal policy, in a country like Burkina Faso it is crucial to re-establish credibility and stabilize the expectations and reactions of economic agents. In this regard, I was somewhat puzzled by the intention to introduce a new value-added tax system, knowing that this system would have to be reformed a year later, owing to its undue complexity. I would have preferred that such stop and go behavior be avoided in order to

provide predictability and creditworthiness to the Government's actions.

As to agricultural production, the staff has noted the strong correlation between weather conditions and real GDP development. I had the impression that, in this regard, the staff had taken a rather optimistic approach to export revenues. I wonder whether it is realistic to expect that there will be in the long run an increase of cotton prices, when, as a result of favorable weather conditions, the production not only in Burkina Faso but also in other countries will increase significantly.

Finally, like other franc-zone countries with a fixed exchange rate regime, not being able to use the exchange rate as an instrument requires greater emphasis on domestic adjustment. However, as with other countries, I am not fully convinced that this adjustment will be sufficient to regain external competitiveness in the medium term, which, in my view, should be a crucial objective, as Burkina Faso's external position remains fragile and its payments viability is not expected to be achieved in the medium term. The maintenance of subsidies for the cotton sector underlines my concern. Therefore, I would be interested in getting more information on Burkina Faso's competitive position in relation to other producers of cotton that are not prevented from using the exchange rate instrument.

Mr. Dorrington noted that the staff intended to discuss with the authorities the feasibility of a contingency mechanism for subsequent years of the program. He firmly believed that such mechanisms could have a very important role in sustaining adjustment in the event of shocks, be they adverse or beneficial, and Burkina Faso was clearly vulnerable to such shocks. Thus, he greatly hoped that that intention would be realized. Indeed, it would have been better if a contingency mechanism had been built into the program from the outset.

He welcomed the very clear tables in the text of the staff report, which helped to inspire confidence in the program, Mr. Dorrington said. Finally, he was pleased to support the proposed decision.

Mr. Kaeser made the following statement:

This chair supports the request of the Government of Burkina Faso for a first ESAF Arrangement.

The staff report gives a realistic assessment of Burkina Faso's present situation and the economic projections for 1993-95. In view of possible deterioration in the external environment, especially concerning cotton prices, I welcome the fact that the staff has examined an alternative scenario, taking into account a 10 percent lower price than that foreseen in the

baseline scenario. In the long term, I share the view of Messrs. Hammoudi and Prader concerning the opportunity of diversification in agricultural production.

We also have some specific questions and remarks to make. I note that the summary table in the policy framework paper, "Description and Timetable of Macroeconomic and Structural Adjustment Policies," lists 101 measures to be taken on schedule by the Burkinabè authorities. Furthermore, Table 2 of the Memorandum on Economic and Financial Policies for 1993 contains structural benchmarks requiring legislative action. I agree that all these measures and benchmarks have to be implemented in order to ensure the success of the program, but I wonder whether we are not heading for trouble with respect to the timely implementation of measures requiring legislative action. The decision-making process in newly created democratic institutions usually works slower than anticipated.

In various parts of the papers, issues of regional cooperation and integration are only briefly discussed. It is obvious that those issues are of utmost importance not only for Burkina Faso, but also for all neighboring countries and others of Western Africa. Therefore, they should be treated accordingly. In this respect, I have a very practical question. I would like to know whether the Fund deals with regional issues and how it deals with them.

Another question I have is with regard to the Banque Nationale de Développement. I am convinced that national development banks have a continuing role to play in financial intermediation as long as capital markets are not well developed. For the time being, they seem to be the only institutions capable of providing long-term credit. I would like to know what decision has been taken regarding the future of the Banque Nationale de Développement in Burkina Faso.

Mr. Al-Tuwaijri made the following statement:

I am in agreement with the thrust of the staff appraisal, and I feel that the authorities' planned adjustment program for 1993 is sufficiently strong to warrant Fund support. Although I share the concerns expressed by other Directors regarding the policy slippages during 1992, I feel that the Government that came to office in June 1992 has already demonstrated its resolve by the corrective fiscal measures taken in the latter part of the year. The authorities should be commended for the early implementation of these measures, which included a repeal of a large civil service wage increase and cutbacks in current spending and transfers. Although these efforts were not sufficient to fully offset the adverse impact of external factors, they helped moderate the growth of internal and external imbalances.

The authorities' commitment to strengthening the adjustment effort in order to build upon the gains achieved under the earlier program is to be welcomed. The degree of fiscal consolidation envisaged under the program is impressive, particularly if one takes account of the fact that the apparent projected deterioration in the overall budget position in 1993 reflects the impact of extraordinary costs associated with restructuring. The authorities appear justified in programming for a somewhat larger deficit in 1993 in order to finance reforms in the banking and cotton sectors and to clear all foreign arrears and reduce domestic arrears, including obligations incurred by the Government with respect to price supports operated by the agricultural price stabilization fund (CSPPA). However, there is little room for slippages in the fiscal area, particularly given the lack of flexibility in exchange rate policy. In this context, I welcome the authorities' efforts to restructure the tax system and improve its administration, and I would urge them to avoid any tax distortions that could create allocative inefficiencies.

The external payments and debt position is projected to remain fairly comfortable during the program period. However, the economy remains highly vulnerable to external shocks, and the authorities should be prepared to take corrective action if lower export earnings or an adverse shift in the terms of trade leads to reserves falling below targeted levels. In this context, I note that the programmed rate of import growth appears rather low. I would appreciate it if the staff would comment on the factors underlying the projected decline in import volume during the latter two years of the program.

With these remarks, I support the proposed decision.

Mr. Ismael made the following statement:

I wish to touch upon a few problems in the course of my intervention.

First, as stated by the staff in its report, the system of turnover taxes, which was complex and difficult to administer, has been replaced, in January 1993, by a value-added tax system, which, in its present form, is equally complex and could therefore reduce collection efficiency. I, therefore, agree with the staff and Mrs. Martel that the value-added tax system should be simplified.

My support is based on a few lessons learned from recent experiences in my own constituency. Thailand introduced its value-added tax system in 1992. This resulted in Thailand's experiencing reduced collection efficiency, which, in turn, reduced tax collection. Indonesia introduced its value-added tax

system in 1984, but had to postpone its implementation for a year because, as it turned out, the revenue system was ill prepared for this event. It is therefore essential that there be a thorough preparation in order that the value-added tax system be implemented effectively, and it should be kept as simple as possible. I, therefore, welcome Burkina Faso's commitment to move toward a simpler value-added tax system when the 1994 budget is introduced.

Second, I note that the population growth rate in Burkina Faso is very high, 4.7 percent, whereas GDP growth targeted for the 1993-95 program period is 3-4 percent. In view of this, I wonder what policy or program is in place, or is being considered, to have population growth reduced to a rate not exceeding the planned GDP growth rate.

Third, how does the inflation rate in Burkina Faso compare with other WAMU member countries? Is it higher, lower, or at the same level? If Burkina Faso's inflation rate is higher, how does it maintain its international competitiveness, as it cannot unilaterally use its exchange rate as the adjustment mechanism of last resort?

I support the proposed decision.

Ms. Patel made the following statement:

Burkina Faso has made progress over the past two years in decontrolling prices, strengthening budgetary procedures, liberalizing trade, and reforming public enterprises. This record of policy implementation, including the corrective measures taken in the second half of 1992 and early in 1993 to compensate for shortfalls in revenue, augurs well for the success of the reform program to be supported by the proposed ESAF arrangement.

As I am in broad agreement with the thrust of the staff's appraisal, I would like to limit my remarks to a few points only.

Revenue in relation to GDP is low, and the picture is not expected to change significantly even by the end of the program period. Despite Burkina Faso's low level of development, a substantial improvement in the revenue position could be made, through the introduction of measures aimed at broadening the tax base and enhancing revenue collection efforts. In addition, efforts could also be made to contain expenditures. In this respect, reorientation of public expenditures with a view to reordering the recurrent outlays and defining a growth-oriented investment program should be seriously considered. These measures are important to improve the fiscal position and contribute to the elimination of domestic and external arrears, as well as to maintain the rate of inflation at a low and sustainable level.

The level of savings in Burkina Faso is low. The authorities should encourage savings and thus provide more room for investment and diversification of production. Moreover, they should strive to improve the competitiveness of the economy within the constraints of the WAMU membership. These measures are especially necessary in view of the narrowness of the export base. In this connection, the authorities should address the bottlenecks in the transportation sector in order to boost exports of minerals, thereby reducing dependence on cotton.

Burkina Faso is prone to natural disasters, especially drought. The damage caused by drought to agricultural and related economic activities has been tremendous. The emphasis given in the policy framework paper to environmental aspects of the program is therefore appropriate.

Finally, the authorities should continue their efforts to strengthen the data system, and, if necessary, the Fund should provide the required technical assistance.

I support the proposed decision.

Mr. Wei made the following statement:

We fully support the proposed decision. Our position is about the same as that of Mr. Al-Tuwaijri. Concerning the simplified wage system, I fully share the view expressed by Mr. Ismael. However, I wonder what the impact is on revenue under such a simplified system and on a system for wage increases with several rates.

The Burkinabè authorities were successful with their adjustment efforts in 1991, but they slowed down the process with slippages in 1992, owing to the fact that the country was overtaken by its political agenda. The economy suffered setbacks as a result of unfavorable weather conditions and the decline of the price of cotton on the international market. To correct the economic imbalance, the authorities formulated a three-year program with ambitious reform measures for 1993-95 that we fully support. We are in broad agreement with the staff's assessment in the report and thus will limit our comments to the fiscal sector.

On the fiscal front, we share the staff's view that the successful implementation of the fiscal reforms that are included in the program is at the core of the program's success. This program's aim is, among other objectives, to reduce the overall fiscal deficit, excluding grants, from an estimated deficit of 6.1 percent of GDP in 1992 to 2.8 percent of GDP by the program's end date in 1995, as stated in Mr. Santos's very helpful statement. On revenue-increasing measures, the authorities are

encouraged to start immediately to improve the tax system. In this connection, it is the correct decision on the authorities' part to introduce the value-added tax system to replace the turnover taxes, which were complex and difficult to administer. Even though we agree with the staff's recommendation that a single rate be used in the value-added tax system in order to enhance collection efficiency, it is our view that, when the authorities have accumulated sufficient experience from the implementation of this single value-added tax rate, they will be better prepared to move toward a value-added tax system with two or three differentiated rates so that revenue will be increased and different enterprises will be taxed in a fairer way.

On the expenditure side, the authorities are encouraged to carry through these ambitious measures, some of which are difficult and sensitive to implement, such as reducing the wage scale by 10 percent across the board as well as the adoption of a promotion system based on merit. In this connection, the implementation of structural reforms is of vital importance in meeting fiscal objectives.

In conclusion, the authorities are commended for their determination and courage in taking this comprehensive program that, upon successful implementation, will improve the competitiveness and efficiency of the country and enable the economy to grow on a sustainable basis. We fully support the proposed decision.

The staff representative from the African Department said that, in considering a contingency mechanism for the economy in the event of external shocks, the staff had concluded that monetary policy was not available for short-term demand management, given the monetary arrangements in the WAMU. For the same reasons, trade policy measures, such as trade restrictions, could not be considered. Thus, only action on fiscal policy remained. However, even in that area, the staff considered that using solely fiscal policy might put too great a strain on the policy, as it would in the near future have to make a major contribution to structural improvements in the economy and should not be used for conjunctural policy.

In addition, there was also a statistical problem related to the use of a contingency mechanism, the staff representative commented. Reliable information on the nature and size of external shocks was weak. Furthermore, there were considerable lags with respect to data on the external accounts. Taking those factors into account, the staff had made a provision for a supplementary budget as a contingency in the event of an obvious deterioration in the external current account. Nevertheless, the staff would continue working on other contingency mechanisms in connection with the midterm review.

In making its projections of cotton prices, the staff, for 1993, had used the prices that had been prenegotiated with the cotton company, and,

from 1994 onwards, it had used the world economic outlook figures, the staff representative said. It was obvious that, with the arrival of the former Soviet Union suppliers to the market, the market had become more competitive. In the long run, pressure on prices would persist. Present prices appeared to be moving up, owing to special circumstances, such as the poor harvest in Pakistan, but that was not an indication of a medium-term development in cotton prices.

The appropriate reserve level was an aspect of the contingency mechanism that served as a buffer when policy action was not sufficiently quick, the staff representative continued. Generally, the appropriate level was determined to be three to four months of imports; however, in the case of Burkina Faso, the authorities were aiming at five to six months of imports, and, given the precariousness of the country's general situation including its dependence on favorable weather conditions, the staff was not discouraging them.

Assessing competitiveness was extremely difficult in small African countries, the staff representative remarked. The Information Notice System (INS) indicator that appeared in one of the staff report's charts had certain shortcomings; principal among them was that it did not include sufficient third-country aspects. For Burkina Faso, the focus for measuring competitiveness was on cotton prices. Cotton prices in Burkina Faso were in line with the prices observed in the other countries of the region. Thus, Burkina Faso had no particular competitive advantage or disadvantage. Another indicator of competitiveness was the losses made by the cotton company, which, as the staff paper reported, were sizable at around CFAF 11 billion. As a result of the price-cutting measures taken by the Government in late 1992, they could be reduced to CFAF 6.5 billion, which remained large and were clearly not sustainable. As a result, the authorities were placing greater emphasis on domestic actions, including structural improvements, to raise productivity and lower costs. It was true that domestic actions should be pursued for their own value, regardless of pressure from either the exchange rate or the need to maintain competitiveness.

The proportion of taxes in GDP remained low even at the end of the program period, the staff representative noted. In considering tax reform, the staff had decided that, in the short term, taxes should not be increased, as private sector initiative was developing and competitiveness was an issue. Furthermore, with respect to the complicated value-added tax system, which required further reform a year after it was introduced, the staff had tried until the last minute to convince the authorities to delay their actions and adopt a system that would be completely in line with proposals for the WAMU. The issue of the value-added tax had been an important element of the staff's negotiations with the authorities, but the staff had recognized its political nature. The first democratically elected Parliament had passed a budget including the changes in the tax regime, and it was considered inappropriate to recommend overturning that decision for the sake of complying with Fund conditionality. As a result, the staff had

decided to recommend that a more efficient system be included in the budget for 1994.

As to comments made that the program was overly ambitious, owing to the country's limited administrative capacity, the staff representative said that the staff, in its discussions with the authorities, had tried to make sure that it understood what the priorities were and what resources would be used. However, it was inevitable that perhaps one measure or another in the program would not be completed as foreseen. The authorities were doing their best to stay within the policy matrix and achieve the desired results.

The staff was making every effort to provide the authorities with technical assistance for tax reform, including Fiscal Affairs Department advice on the expenditure side of the fiscal situation and monitoring of the budget, the staff representative said. Similarly, the World Bank was trying to obtain technical assistance in its areas of priority.

There would be a regional consultation with the Central Bank of West African States shortly, the staff representative said. Among the issues that would be considered were clearly defined and advanced proposals for tax harmonization and for harmonization of statistics with respect to government operations. The Fund was involved in making recommendations on a regional level.

The Government had recently decided to privatize the National Development Bank (BND-B) and was in contact with a foreign investor, the staff representative noted. However, given the number of problems the bank had, indicated by the major restructuring operation that had been carried out in 1991 and its present need to resolve nonperforming loans and correct cumulative losses, the authorities had indicated that the bank would be liquidated should the negotiations fail.

As to the decline in import volume projected for 1994-1995, the staff representative continued, it should be seen in the perspective of the increase in volume of more than 36 percent from 1989 through 1993, which implied a very high import elasticity. That boom had been primarily due to large amounts of investment goods and food imports. In making the projections for investment goods imports, the staff had adjusted them to the availability of external financing. The performance of food imports in recent years had been disappointing. However, the staff assumed that more normal weather conditions would prevail in future and that the structural measures that the authorities were taking in the agricultural sector would have more positive effects. Therefore, as domestic food production increased, import volumes on food products would decline.

Diversification of agriculture was a clear objective in the policy framework paper, the staff representative commented, and there was an agricultural adjustment program with the World Bank. In addition, population issues were under the domain of the World Bank and were included in the policy framework paper.

Burkina Faso had a very good inflation record compared with the rest of the region, the staff representative from the African Department remarked, even if those countries whose exchange rates had considerably depreciated over the past two years were excluded.

The staff representative from the World Bank noted that the issue of population growth was at the center of the staff's discussions with the Government on the subject of human resources. The Bank staff was currently preparing a health and nutrition project that would address population policies. That topic was receiving much attention from the staff and the Government, and he hoped that the population growth rate would be reduced.

The World Bank's program of adjustment in the agricultural sector was essentially aimed at liberalization, the staff representative said. As there were no obvious substitutes for cotton, the goal would be to maximize the supply response and decrease the amount of food imports, in particular through more efficient production of cereals. Thus far, the reform undertaken in the cereal subsector had been promising. The program was relatively new and was still on track.

By improving the environment for private sector activity, the staff's strategy was to diversify the real sector by expanding mineral production, the staff representative from the World Bank remarked. There was a potential for mining gold, and private investors had expressed interest in making the necessary infrastructure investments for extracting manganese deposits.

Mr. Santos thanked the Executive Directors for the broad interest they had shown in Burkina Faso's adjustment process. He was particularly encouraged by offers to extend to Burkina Faso the concessional terms that had been made available by Paris Club creditors to other countries with the same level of income and which had made the same degree of effort. He was also encouraged by the critical importance Directors had attached to structural reform and to the risk of overburdening the country's administrative capacity, and by the attention they had given to improving technical assistance to the Burkinabè authorities.

Much had been said in the Board discussion on the introduction of the value-added tax, its complexity, and the administrative apparatus needed for its implementation, Mr. Santos continued. The Burkinabè authorities had thought that postponing the introduction of the new system was detrimental to the program and, therefore, had preferred to go ahead with its implementation with three different tax rates, which they expected to unify to one rate of 15 percent by about 1994.

The Burkinabè authorities concurred that there was a need to balance population growth with the available resources, Mr. Santos said. Paragraph 30 of the policy framework paper stated that the social development of the country was possible only if the rate of population growth was

compatible with its resources. The authorities were preparing a comprehensive family planning strategy that would be available soon.

The authorities were making great efforts to correct the financing imbalances that remained, as the staff papers' tables indicated, Mr. Santos noted. Although the staff encouraged the authorities to make greater efforts, how much further they could go without losing popular support was difficult to judge; that would depend on how the economy reacted to the structural changes and on the growth of the economy, and, specifically, job opportunities. That dialogue would continue.

The Chairman made the following summing up:

Executive Directors welcomed the authorities' renewed emphasis on the restoration of financial stability and the acceleration of structural reform in Burkina Faso. They also noted the indications of determined performance at the start of the ESAF program. The attainment of financial stability required above all, a tight and effective control of government finances. To that end, it was imperative for the new Government to establish a solid record of financial discipline and to send unmistakable signals for the direction and strength of structural reform. Directors, therefore, encouraged the authorities to remain steadfast in the implementation of the financial policies and structural reforms set out in the proposed ESAF-supported program and in the pursuit of the necessary political and social consensus building.

Even though commendable progress had begun to be made in the development of an open market economy, significant measures were still needed to remove distortions, improve incentives, and, generally, give greater scope to private initiative. To this end, it was essential that the liberalization of trade and prices and the streamlining of the regulatory framework be brought to term. Directors also encouraged the authorities to forcefully advance their privatization program and to improve the operations of public enterprises through efficiency-enhancing measures.

Directors noted the authorities' concern about the improvement of competitiveness and welcomed their preparedness--in the framework of Burkina Faso's participation in the regional fixed exchange rate system--to take strong domestic action to reduce costs and enhance productivity. The reduction in producer prices of cotton for the 1992-93 season, although insufficient to eliminate the need for subsidization of the cotton sector, was an important step toward a more flexible response of domestic costs and prices to movements in world market prices. Directors believed that, over time, competitiveness would also benefit significantly from the envisaged strengthening of market mechanisms and incentives. Nevertheless, Directors observed that

Burkina Faso's external prospects remained fragile and vulnerable to external shocks. The uncertain prospects of the cotton sector further underscored the need to accelerate the required reallocation of resources toward the traded goods sectors. Directors also felt that, with the strong implementation of adjustment and reform policies, Burkina Faso deserved to receive very generous assistance from donors and creditors.

On fiscal policy, Directors observed that the authorities had taken important steps toward an improvement in revenue performance. The replacement of the turnover tax by a well-prepared and simplified value-added tax--on which work was already in progress--could reduce distortions, improve transparency, and increase economic and collection efficiency. Additional benefits could be derived from a further simplification of the tariff system and rationalization of the taxation of petroleum products. These actions, therefore, needed to be completed without delay.

On the expenditure side, Directors called for a comprehensive reorientation of policies toward development priorities and major social and education needs, while holding down current outlays, particularly on the wage bill and military expenditures.

Directors noted the large financing requirements for banking sector restructuring that, in their view, had resulted mainly from excessive government interference in the past. To reduce the risk of a recurrence of such developments and to make progress toward effective financial intermediation and improved credit allocation, Directors felt that the intended privatization of banks had to be carried out with all necessary speed. Directors believed, moreover, that the move toward a sound banking system and increased lending to the private sector needed to be supported by rigorously enforced prudential ratios.

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

The Executive Board then took the following decision:

1. The Government of Burkina Faso has requested a three-year arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund notes the policy framework paper for Burkina Faso (EBD/93/39).

3. The Fund approves the arrangements set forth in EBS/93/35, Supplement 1.

Decision No. 10326-(93/42), adopted
March 31, 1993

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/93/41 (3/29/93) and EBM/93/42 (3/31/93).

3. INDIA - REPRESENTATIVE RATE FOR INDIAN RUPEE

The Fund finds, after consultation with the authorities of India, that the representative rate for the rupee under Rule 0-2(b)(i) is the midpoint between spot buying and selling rates for the U.S. dollar based on market rates prevailing at 12:00 noon each day in Bombay, as ascertained and reported by the Reserve Bank of India. (EBD/93/51, 3/25/93)

Decision No. 10327-(93/42), adopted
March 30, 1993

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/93/53 (3/29/93) is approved.

APPROVED: November 2, 1993

LEO VAN HOUTVEN
Secretary

