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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/7

10:00 a.m., January 15, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	A. G. A. Faria, Temporary
Dai Q.	Jiang H.
C. H. Dallara	D. C. Templeman, Temporary
	E. L. Walker, Temporary
J. de Groote	J. Prader
A. Donoso	
M. Finaish	
G. Grosche	B. Goos
J. E. Ismael	J. Reddy
	J. R. N. Almeida, Temporary
	C. Enoch
	R. Comotto, Temporary
	D. McCormack
Mawakani Samba	
Y. A. Nimatallah	I. A. Al-Assaf
	L. Filardo
J. Ovi	M. Fogelholm
	G. Pineau, Temporary
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
K. Yamazaki	S. Yoshikuni
	F. Di Mauro, Temporary

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant
D. de Vos, Assistant

1. Surveillance - Indicators - Commodity Price Baskets . . . . . Page 3
2. Qatar - 1987 Article IV Consultation . . . . Page 22
3. Burkina Faso - 1987 Article IV Consultation . . . . Page 35
4. Haiti - 1987 Article IV Consultation - Postponement . . . . . Page 46
5. Executive Board Travel . . . . Page 46
6. Travel by Managing Director . . . . Page 46

Also Present

African Department: S. E. Cronquist, R. E. Daumont, M. De Zamaroczy, P. H. Matthieu, S. M. Nsouli. European Department: J. R. Klein. Exchange and Trade Relations Department: S. J. Anjaria, S. Kanesa-Thasan, L. M. Valdivieso. External Relations Department: R. J. Bhatia, Director, Fund Office in the United Nations and Special Representative to the United Nations; N. Worth. IMF Institute: O. B. Makalou. Legal Department: H. Elizalde, J. V. Surr. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; M. Bell, J. G. Borpujari, H. P. G. Handy, D. B. Noursi, B. K. Short. Research Department: J. A. Frenkel, Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; J. M. Boughton, R. P. Flood, N. M. Kaibni, F. Larsen, A. Muttardy, B. E. Rourke, J. J. Soladay. Bureau of Statistics: A. K. Patel. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. A. Agah, M. B. Chatah, A. Ouanes, N. Toé, J. E. Zeas. Assistants to Executive Directors: N. Adachi, F. E. R. Alfiler, S. K. Fayyad, V. J. Fernández, S. Guribye, C. L. Haynes, M. Hepp, G. K. Hodges, A. Iljas, S. King, K. Kpetigo, V. K. Malhotra, T. Morita, D. V. Nhien, J. K. Orleans-Lindsay, G. Schurr, C. Sel, C. C. A. van den Berg, R. Wenzel, Yang W., I. Zaidi.

1. SURVEILLANCE - INDICATORS - COMMODITY PRICE BASKETS

The Executive Directors continued from the previous meeting (EBM/88/4, 1/11/88) their consideration of a staff paper on commodity price baskets as possible indicators of future price developments (SM/87/291, 12/11/87).

Mr. Mawakani made the following statement:

I welcome the staff's ongoing efforts to strengthen the process of multilateral surveillance through the use of economic indicators. This discussion is part of the search for an additional variable for monitoring the economic performance of industrial countries. Every effort to predict the outcome of economic and financial developments in those countries and to help create a stable international economic environment should be encouraged. The staff paper provides useful background information on the potential ability of a commodity price index to foretell price developments in industrial countries. In addition, it highlights the complexity of the use of this index as an early warning indicator of economic developments.

I support the use of leading indicators, including commodity price indices, provided that there is sufficient evidence to show that the new indices send a reliable early warning signal of price developments and that the ensuing policy responses by industrial countries do not adversely affect the economic performance of developing countries. Charts 1, 2, and 4 show that there is little relationship between the movements in the consumer price indices in the major industrial countries and the movements of the existing commodity price indices surveyed by the staff. The conclusion to be drawn from the charts is clearly stated on page 17: "All of the commodity price indices...show essentially zero inflation through 1972, a very rapid increase from 1973 through 1974, and high volatility but again no inflation during the remainder of the 1970s and into the 1980s. Whatever the merits of these indices might be, it is clear that this long-run pattern is very different from that of the consumer price indices of the large industrial countries." In fact, Chart 1 shows that there is a stronger correlation between consumer price indices and normalized unit labor costs; this might be a promising avenue, and the staff should concentrate its efforts in this direction.

The econometric approach to constructing a commodity price index seems impressive, but considerable caution should be exercised in estimating the weights and interpreting the close fit between commodity price indices and the consumer price indices. The staff should explain why the weights derived econometrically are so different from those based on consumption and trade patterns and the conclusions that can be drawn from these divergences. Assuming that the commodity price index proves to be a reliable indicator of price developments in industrial countries, I wonder what the policy implications for the industrial countries would be. If the message conveyed by the movements in the commodity price index triggers measures aimed at depressing commodity prices, I would strongly oppose the use of this index as a supplementary leading indicator. If anything, the industrial countries should endeavor at least to stabilize commodity prices. The staff should comment on the relationship of international commodity agreements to movements in commodity prices.

Since many questions remain unanswered, it would be premature to conclude on the basis of the present paper that commodity price indices could be used to predict future price movements in industrial countries. An important lesson that can be drawn from the staff paper is that developed countries' policies have a negative impact on commodity prices. Future discussion on this subject would be enriched by an analysis of the predictive ability of normalized unit labor costs and other leading indicators, as well as by an examination of the stability of the relationship between manufactured goods prices and commodity prices.

Mr. Donoso made the following statement:

I welcome the initiative on additional indicators to anticipate inflationary pressures. The staff has made a significant effort to study this matter and has found that there appears to be a basis for considering the prices of commodities to be a useful indicator of potential inflationary pressures. However, it is clear that the conclusions are still tentative and that much work is still needed to select the one or several indices that appear to be most useful and to link the indications they provide with concrete policies to avoid inflation. It is important to analyze further the causal relationship between prices of commodities and future inflation before indices of commodity prices are included among the Fund's indicators.

The Fund has conducted research on commodity prices for a long time and has contributed to a better understanding of the behavior of those prices. Studies presented during earlier world economic outlook exercises indicate that the dollar prices of commodities have moved with contemporaneous inflation and have increased in real terms along with any depreciation of the dollar, acceleration of growth in industrial countries, and reductions in interest rates.

In the past, fluctuations in commodity prices have been explained mainly by changes in demand conditions. Recently, however, the staff included a supply element in explaining the depression of commodity prices in 1984-86, when the dollar was depreciating, GDP in industrial countries was recovering, and interest rate increases had moderated; in those circumstances, the staff suggested explanations of commodity price behavior based on demand conditions alone were insufficient. The staff found that increases in supply in response to previous increases in prices explained the low commodity prices in 1984-86. These findings should be considered when work is undertaken to define indices of commodity prices to be used in anticipating inflationary pressures.

It is conceivable that, in any given period, the factors leading to an increase in commodity prices might also have the potential of inducing an increase in the rate of inflation, thus supporting the notion that, in general, increases in commodity prices anticipate increases in the consumer price index. However, some of the studies mentioned by the staff indicate that the prices of commodities increase for reasons that are not directly related to future inflation. For example, if commodity prices increase because of a rise in the rate of growth in industrial countries, there need not necessarily be reason to expect an increase in the rate of inflation. One should not expect an acceleration of inflation in a situation in which commodity prices are rising but there is no increase in monetary stimulus. However, an index of commodity prices measured in SDRs would appear to be increasing in those circumstances and would lead one to predict an increase in the rate of inflation. Therefore, an attempt should be made to differentiate among the reasons for increases in commodity prices in order to isolate those that account for inflation. There are good reasons to expect that developments leading to accelerated inflation will be reflected first in commodity prices. However, hitherto, excessive confidence has been placed in statistical findings that might be hiding a more complex causal relationship between commodity prices and the rate of inflation.

The staff's work is a good start, but we still do not have an indicator of inflation that is a useful instrument for orienting macroeconomic policies. Much work remains to be done, and the staff should undertake it and report on its progress.

The choice of the particular index to use should be based on which index is easiest to interpret and which one does the most to improve our understanding of the relationship between variations in the prices in the index and in the rate of inflation. An index that is built mainly with the particular weights of its components in mind would not be significantly useful in anticipating inflation.

Mr. Almeida said that, as a rule, the approach of this chair to the Fund's operations and procedures was based on the principle that things should be kept as simple as possible. Consequently, only indices that were clearly of economic significance should be used. The Fund should not try to devise indices based on models that were so complex and cumbersome that they could be understood essentially only by the model builders themselves.

The staff paper clearly lacked key information on when the proposed indices could be made available for detailed analysis, Mr. Almeida remarked. The purpose of the indices was to improve surveillance, policy coordination, and the world economic outlook exercise, and, to those ends, timing was crucial. The staff paper could have usefully indicated how the data in the proposed commodity indices would be and how the actual indices would differ from preliminary indices based on incomplete information. Moreover, the staff could have usefully noted previous cases in which the proposed indices have given wrong signals about the prospects of an economy.

As to the questions posed by the staff on page 29, it was still too early to conclude that commodity price indices might be useful indicators of inflationary pressures, Mr. Almeida commented. All indicators should include gold and petroleum for the practical reason that those commodities were important. Since it was difficult to define "a reasonable pattern of weights," as mentioned on page 29, that should not be the criterion used to choose an index. Instead, the choice should be based on an index's record of ability to predict inflation. The Fund should never use indices that had failed to foresee significant changes in inflationary trends in the past.

Like Mr. Enoch, he wished to see more work done in the area of commodity price indices, including statistical series and comparisons between expected inflation, as measured by the proposed indices, and actual inflation, Mr. Almeida said. There should also be some work on the form of presentation of indices--for example, how and when indices would be published.

Mr. Dai made the following statement:

> The list of indicators can and should be flexible, reflecting on actual conditions and the purposes of the indicator analysis. Hence, I would have no difficulty in accepting commodity price indices as an adjunct to other indicators, if the commodity price indices helped to strengthen multilateral surveillance and promote policy coordination among the major industrial countries.
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> Nevertheless, I am somewhat skeptical about the reliability of commodity price indices as a useful indicator of future price developments. As the staff has indicated, commodity price movements have reflected largely shifts in relative, rather than

absolute, prices, and there is no stable long-term relationship between commodity and consumer prices. The staff paper gives the impression that, even after some econometric manipulation, the correlation between commodity and consumer prices is weak. Second, while financial variables do have a sizable effect on commodity prices, supply-induced changes in commodity prices may not be closely related to the general trend of inflation. Experience has shown that commodity prices can be influenced by the decisions of producers or by holders of some particularly important commodities. In such cases, the link between the inflationary trend and commodity prices could be greatly obscured. Consequently, we cannot always be certain whether major movements in commodity prices are caused by changes in supply or by changes in demand. In addition, in responding to changing circumstances, commodity prices often tend to overshoot substantially for extended periods.

Therefore, we must be very careful in interpreting the relationship between movements in commodity prices and changes in inflationary conditions. Other, more relevant factors are worth emphasizing in the effort to find an early signal of inflationary trends. It is true that the inappropriate economic policies, especially fiscal and monetary policies, of major industrial countries used to be the main cause of global inflation. As the staff has suggested factors that are related directly to the general inflationary trend, such as money balances and unit labor costs in industrial countries, appear to be especially viable candidates as indicators of future price movements. It is well known that there is a lag between monetary expansion and the associated acceleration in the rate of inflation, and that an increase in monetary aggregates tends to lead major swings in consumer prices. Therefore, it may be worthwhile to study further the predictability of changes in monetary aggregates in relation to inflationary trends.

I agree with Mr. Posthumus that it is not the lack or weakness of the available indicators that hampers coordinated policymaking. The real difficulty is the lack of effective action in response to the indicators that are already available. The indicator exercise is widely recognized to be an important instrument in strengthening multilateral surveillance and in promoting policy coordination among the major industrial countries, and I hope that our future efforts in this area will lead to some concrete results in curbing the turbulence in the current financial markets and in eliminating the enormous imbalances in the world economy.

Mrs. Filardo made the following statement:

It is unfortunate that the two advocates of this proposal have not guided the staff adequately in this matter or set the tone of the debate. It is likely that the existence of different explanations of this subject and the lack of direction by the United States and the United Kingdom led the staff to try in the present paper to develop diverse commodity price indices as indicators of future inflation in order to encourage central banks to monitor exchange and monetary policies, thereby helping in the effort at policy coordination among the G-7 countries.

The staff paper correctly notes that in examining whether an index of commodity prices might be a helpful addition to the list of existing indicators, one of the most important criteria is whether the index provides information at an early stage in the process of the intensification of inflationary pressure.

On the basis of its empirical analysis of the relationship between commodity prices and general inflation, the staff concludes that there is a link in both directions, but also that the commodity price indices show great variability one time and tend to overshoot substantially and for long periods in response to changes in circumstances. Another finding is that when movements of commodity and consumer price indices do not coincide, a shift in the supply of and demand for individual commodities has probably taken place. It is clear that, as Mr. Nimatallah stated, a commodity price index is characterized not only by sharp fluctuations in supply and demand, but also by the fact that those fluctuations are a reaction to changes in demand and consumer price indices and are generally influenced by the stance of financial policies in industrial countries themselves. Rather than construct an artificial index that would send the wrong signals, it would be appropriate, as Mr. Enoch stressed, to analyze how commodity prices are influenced by policies in the industrial countries.

Notwithstanding the objections that I have mentioned, the staff has made a good start in constructing different indices, although it is clear that none of them can serve individually the ideal purpose of promoting policy coordination among the G-7 countries; each can serve only as an additional indicator. However, as we have seen during recent world economic outlook discussions, rather than looking for a scapegoat, industrial countries should tackle their structural problems more decisively than hitherto.

I agree with Mr. Posthumus that, in our effort to obtain a useful index, we might well end up with an arsenal of indices that are an enormous burden on the limited staff resources. Therefore, if the objective of this discussion is to select an index or indices that bear a close relationship to price movements in industrial countries, the most appropriate ones that could be added to the existing list are those that take into account imports and consumption patterns in the G-7 and other large countries. The inclusion of oil in these additional indicators appears to be particularly significant, especially because by itself oil constitutes half the total consumption of all the commodities included in the suggested indices.

Mr. Dallara made the following statement:

We welcome this opportunity to discuss the use of a commodity price index as an economic indicator in the Fund's work and in the context of international economic policy coordination, particularly among the major industrial countries. At the 1987 Annual Meetings, Secretary Baker stated that the United States was prepared to consider utilizing, as an additional indicator in the coordination process, a commodity index that would better help us to understand the relationship between currencies and a basket of commodities, including gold. This approach was seen by Secretary Baker as being potentially helpful as an early warning signal of potential global price trends. As Secretary Baker noted in his statement at the 1987 Annual Meetings, it would be unfortunate if efforts to foster exchange rate stability among currencies led eventually to stable currency relationships but in a context of overall global inflationary or deflationary policies that affected the real value of those currencies. It is obviously not inconceivable that there could be a circumstance in which one could achieve some significant degree of relative price stability among major industrial countries and, therefore, perhaps some relative stability in their currencies, while the underlying price trends suggested a potentially counterproductive inflationary or deflationary bias. In this context, my authorities continue to view a proposed indicator of this nature as an analytical tool to be used in conjunction with other measures of economic performance in reaching judgments about policies and performance.

In the light of comments by previous speakers, it is clear that there may have been some misunderstanding about the nature or thrust of Secretary Baker's proposal. Mrs. Filardo is perhaps correct in suggesting that it would have been helpful for this chair to set the tone for this discussion, although I am not confident that, having done so, we would have been fully aware at the outset of the discussion of the misunderstandings that might have existed. At this point, I certainly am aware of them, and I hope that my comments can dispel some of them.

There have been some references to, and criticisms of, the possible use of a commodities indicator as a direct and almost sole guide to exchange rate or monetary policy. I wish to assure Executive Directors that my authorities' interest in this area is focused on the much more modest and limited objectives that I have mentioned and not on far-reaching notions involving a major change in the role of gold in the monetary system or the use of a formal "anchor" around a commodity index for exchange rate movements, or the use of a commodity index as a direct basis for the management of monetary policy. A commodity indicator would only be a supplement to existing indicators; it would by no means be a replacement for national indicators, and it should not distract us from the ongoing effort to strengthen the use of national indicators and, more generally, the indicator exercise. Indeed, the focus of our efforts should be on the strengthening of the indicator exercise based on national indicators, but this indicator could provide an important supplementary source of information.

It is true that the list of indicators being used in the Fund and by industrial countries already includes industrial country price indices, and that policymakers must of course focus to a large extent on inflationary conditions in their economies in making policy decisions. However, there is a potential need for a usable measure--if one can be found--of global inflationary or deflationary trends that goes beyond the strictly national indicators already available. There is a solid conceptual basis for believing that sensitive commodity prices may help to meet this requirement, as the staff has demonstrated.

Work by the staff on a commodity indicator of this sort could be a natural outgrowth of ongoing work by the Fund to compile and analyze commodity price movements in connection with the world economic outlook, the operation of the compensatory financing facility, and assessments by the staff of the export prospects of individual countries in connection with the Fund's surveillance. The staff has already done extensive work on the subject. It is clear that the staff did not discover the subject of commodity indices following the speeches at the 1987 Annual Meetings by Chancellor Lawson and Secretary Baker. A wealth of information was already available. In fact, when I began to improve my own personal knowledge of this issue in the period preceding Secretary Baker's speech, I was somewhat surprised at how much analytical work there already was. Therefore, it is not clear to me that further development of this effort is necessarily going to involve a tremendous additional amount of staff work, as some Directors have cautioned against.

Many of the technical questions concerning possible use of commodities as an indicator are questions which I believe were directed more to the staff than to those of us who represent the authorities who made proposals. I would, therefore, only make one or two points on technical issues. There is no doubt that interrelationships between commodity price movements and consumer price inflation are complex and work in many directions. However, to a considerable extent, some of these deficiencies could be dealt with through the careful selection of the specific commodities chosen for the index and careful selection of the weights used. It is also clear that considerable judgment would be needed in assessing the implications for global price trends of the latest data from any commodity index or indices.

Since inflationary expectations are such an important factor in actual inflation, commodities that traditionally serve as a hedge against inflation, particularly gold, would be natural candidates for inclusion in any such commodity index. Gold prices admittedly can be affected by other factors, such as supply shocks, but this possibility does not disqualify gold in any way from inclusion in a commodity index; nor should the special historical aura associated with the role of gold distract us from gold's potentially technically sound use. The staff paper suggests that the weight given to gold in consumption in industrial countries may understate its importance as a possible indicator of global inflation, and the correlation tests in the staff paper tend to support this conclusion. Therefore, it would be desirable to consider weights for gold that take into account not only gold's role in consumption in the major industrial countries, but also its ability to predict inflation as suggested by the staff's analysis.

The question whether to include oil prices in the commodity index is difficult to answer. My position is close to that of Mr. Ovi. There is no question of oil's importance as a commodity either in trade or consumption among the major industrial countries, and it would be a serious analytical mistake to ignore that role. At the same time, oil could have a large, perhaps dominant, influence on any index. In addition, I recognize that there are interactions between oil prices and consumer price indices, but my authorities in no way have in mind the possible inclusion of oil in a commodities index as an effort to demonstrate any causal relationship between oil prices and price trends in industrial countries; that would not be the purpose of a commodities index with or without oil. Rather, the role of oil in the index would be the same as that of other commodities included, namely, as one component signaling potential shifts in global price trends. On balance, I am inclined to think that we should keep a foot in both camps, by constructing an index that excludes oil--perhaps focusing our attention primarily on that index--while either also developing an index that includes oil, or tracking oil separately, as previous speakers have suggested.

I attach a high priority to the predictive ability of an index. At the same time, the index should be on solid ground in terms of economic theory. A better understanding of the process that links commodity and consumer prices would facilitate the selection of both the commodities to be included in an index and the relative weights for each commodity selected. In particular, the extensive focus on econometric weights in the staff paper should not lead us into what is referred to on page 14 of the paper as the "Hall trap."

Of course, as many speakers have stressed, further work will need to be done before any decisions can be made on which index or indices to focus on. For example, there should be further work on how best to accommodate different lags and on how to select appropriate weights. We would welcome a fuller discussion of an index providing broad coverage based on consumption weights for commodities other than gold as an alternative to an index based on regression weights, which was the main focus of the staff paper.

It is interesting to note that the correlation between the indices in the staff paper and world inflation in 1979-87 is somewhat evident, even though commodity prices were on a downward trend in that period while global inflation was rising and falling. That finding raises the important question of the appropriate base period to be used. In that context, apparently neither the 1960s nor the 1970s are very relevant to the situation in the 1980s. We wonder whether a midpoint of the high and low periods of the 1980s could be examined as a possible benchmark.

As to the question of how many commodities to include in the basket, the three indices of 40, 22, and 8 commodities developed by the staff present a number of alternatives. None of those indices seems to offer a clear-cut advantage--perhaps appropriately so, at this stage although they could provide useful information. The 8-commodity index seems to predict the best, but its volatility and the limited scope of coverage--it excludes many of the commodities that some Executive Directors feel should be included a priori--are negative factors. The 22-commodity index may be a sensible compromise. Careful analysis of this issue is needed.

In sum, a commodity price index could serve as a useful supplementary indicator of aggregate inflationary or deflationary conditions. Gold clearly should be included in such an index, with its weight reflecting not only its consumption, but also its predictive possibilities. The issue of the inclusion of oil should be examined further, and there should perhaps be two indices, one with oil and one without. As to the question of weighting, strong emphasis should be given to predictability, but emphasis also needs to be given to the reasonableness of the pattern of weights and the general composition of the index. Further work in this area should be undertaken. We do not have definite views on the best format or particular procedures for that further work. We hope that future world economic outlook exercises can include some of the products of the further analysis by the staff; if the staff and other Executive Directors thought that it would be useful, the staff could attach to the fall 1988 world economic outlook paper a technical paper as an appendix that would reflect some of the further work done by the staff on some of these difficult technical issues.

As Mr. Posthumus and Mr. Ovi said, it is clearly not the absence of a commodity price indicator that is at the heart of the surveillance and policy coordination problems facing the major industrial countries. However, I hope that they would agree that, while the Executive Directors should not delude themselves into thinking that this is a potentially major answer to the problems of coordination, we also owe it to our authorities not to simply say that there are no deficiencies in our indicator analysis and that all the problems concerning coordination are traceable to the authorities' ability to produce adequate policies. The Fund must continue its efforts to improve the technical framework within which members have committed themselves to work. Certainly no one would feel comfortable in claiming that the technically optimal state of indicator analysis has been achieved. Indeed, we are far from that state. Further work in this area is entirely justified.

Mr. Enoch commented that a position in favor of a commodity price index did not imply that there was necessarily a causal relationship between movements in commodity prices and the behavior of inflation in industrial countries. As some speakers had suggested, exogenous shocks, such as an increase in the fiscal deficits of the industrial countries, might well play a role in inflation. At the same time, since commodity prices moved in a much more flexible manner than, say, the prices of manufactures, movements in commodity prices might give a forewarning of movements in the prices of manufactures without the one causing the other. At the same time, there were clearly cases of price movements in which some degree of causality exists.

The function of commodity price indicators was to provide information in addition to that which was already available, Mr. Enoch said. None of the indicators--including commodity price indices--should be interpreted mechanistically. Some indicators, such as monetary growth, were frequently thought to be more useful than commodity price indices, especially for individual industrial countries, but the issue became more complex when the objective was to have an index that was an aggregate. One approach to monitoring policies in the industrial countries as a group was to aggregate preferred noncommodity indicators of the different countries concerned. However, looking at, say, monetary aggregates involved difficulties of aggregation that were at least as challenging as the problems that previous speakers had noted in connection with the broad commodity price aggregations that had been discussed at the present meeting. Even if aggregation of monetary indicators from individual countries could be accomplished, there would be no clear theoretical rationale for selecting the resulting aggregate as the preferred index. Some countries had narrow indicators, while others had broad ones, but some kind of aggregate was common to most countries.

It was against that background that Chancellor Lawson's idea should be seen, Mr. Enoch remarked. Although there were some difficulties in developing a commodity price basket, the idea of such a basket was relatively simple and the rationale for it was relatively clear.

The point made by several Executive Directors that the relationship between commodity and consumer prices was not always clear was well taken, Mr. Enoch said. However, under [illegible]'s authorities' proposal, commodity prices would be assessed in a judgmental manner. Moreover, the process of examining commodity prices would include broad, as well as narrow, indices; no single index could provide the full information that was desired. While he recognized that, in some circumstances, the Fund would be able to draw only a little additional information from commodity price developments, it was likely that a sharp rise in a commodity price index at a time of rapid monetary growth in industrial countries would be an important signal.

Considerable doubt had obviously been expressed by a number of Executive Directors about the proposed indicators, and some Executive Directors remained unconvinced that such indicators would be useful, Mr. Enoch remarked. The further work on commodity price indices could be carried out in the context of the world economic outlook exercise; as Mr. Dallara suggested, that effort probably would not involve much extra work for the staff, as there was already a considerable body of relevant analytical material. Perhaps the technical paper that Mr. Dallara had suggested attaching to the paper would be an appropriate way forward.

Mr. Posthumus said that he fully agreed with Mr. Dallara that the Fund had clearly not gained a perfect understanding of the extent to which commodity price indicators could be useful. However, the main point at the present stage was that the Executive Board would have to decide whether it wished to continue to devote resources to the search for appropriate commodity price indicators. That decision need not be made immediately, but it would have to be taken sooner or later.

Mr. Yamazaki commented that the relationship that one might perceive between consumer and commodity prices depended upon the time period that was chosen. Commodity price indicators warranted further examination, although he agreed with Mr. Dallara that such indicators should not be either a formal anchor of the international monetary system, or the direct basis on which monetary policy was formulated.

The Director of the Research Department noted that the staff paper was designed to focus attention on the technical issues in the design of possible indicators of future price developments; it was not meant to be a part of an examination of possible new foundations for the international monetary system. It was, of course, always helpful to bear in mind possible improvements in that system, but the proper way to do so was to deal with systemic issues rather than a particular mechanism for predicting the trend rate of inflation in industrial countries. The staff paper was intended to raise issues concerning the possible role of a commodity price indicator, including the potential implications for policymakers, importers and exporters, and others. At the same time, it was important to consider whether the information provided by commodity price indices would be useful. In that connection, an important criterion was whether such information enhanced the process of policy coordination. Another possible area of investigation was how policy actions over the previous ten years might have been different if a commodity price indicator had been used. A difficulty with that approach was that, as some Executive Directors had stressed, the relationship between general price movements and commodity price movements changed over time and the relevant data could be interpreted in several ways, thereby yielding different conclusions. Further study was clearly needed, and the stage had not yet arrived at which strong inferences from commodity price indices could be drawn.

One of the questions that had been raised was whether the existing indices of inflation were adequate, the Director recalled. As Mr. Faria had suggested, any increase in the information available to policymakers should be encouraged. A balance should be reached between the need to provide adequate information and the possibility that an excessive amount of information would be made available; in that context, the financial and nonfinancial costs and benefits of work on indices needed to be taken into account. As Mr. Dallara and Mr. Enoch had indicated, it was important to recognize that a given pattern of exchange rates might be consistent with both rising prices around the world or falling prices. If one had in mind not only exchange market stability, but also some consideration of the value of money in general, then an additional kind of indicator might be required.

Naturally, the next question to consider was what should be done when the chosen indicator showed an upward trend in world prices in a period of exchange market stability, the Director continued. In that context, and in the absence of any other information, one might conclude that the effort to maintain exchange market stability should not be based on expansionary policies. However, the policy alternatives would not be straightforward if there were also high rates of unemployment around the world. As a number of speakers had stressed, there would clearly be a need for judgment in using new indices. It would, of course, be desirable to avoid having to deal with conflicting signals that were sent because too many indices were being used.

Executive Directors had naturally stressed that the weights assigned to the commodities in a commodity price basket should be reasonable, the Director remarked. However, the purpose of an index had to be established before "reasonable" weights could be assigned to the commodities in the basket. Moreover, while, as Mr. Almeida suggested, the commodity price index should not be excessively complex in relation to what the index was meant to achieve, some optimal amount of complexity would be needed in order to ensure good forecasts. At the same time, the complexity of the index must reflect a good understanding of how individual commodity prices were eventually translated into general price developments.

As a number of speakers had also stressed, it was important to remember that commodity price data that were used as an indicator of future inflation were also used in making inferences about other important policy variables, such as the terms of trade of developing countries, the Director remarked. Those uses of the same database were not mutually exclusive and work on both should proceed.

In the coming period, the staff would wish to continue with ongoing work on commodity prices and inflation, the Director of the Research Department commented. The staff would undertake some of that work in the context of the world economic outlook, but it was important to bear in mind that the staff was still at the stage of in effect establishing the infrastructure of its work on commodity price indices.

Mr. Donoso said that he wondered whether it was not more important to try to anticipate inflation in certain individual countries rather than to seek to anticipate global inflationary pressures through the use of selected indices.

The Director of the Research Department considered that it was helpful to try to understand the relationship between the pattern of exchange rates and the inflationary or deflationary tendency in the global economy. Policy changes made by any particular major country would of course have an impact on the world economy. Therefore, it was important to have an understanding of the global inflationary or deflationary trend. The present discussion had strongly suggested that no single indicator would be able to identify the trend, and that any particular indicator must be supplemented by others. Having indicators of global inflationary or deflationary trends seemed to be particularly important in periods in which policymakers received conflicting signals from national price and unemployment data.

The staff representative from the Research Department said that the staff would wish to answer some of the technical questions on a bilateral basis. One of the general issues was the extent to which there was a stable relationship between commodity and consumer prices. The discussion had clearly shown that commodity prices behaved very differently from consumer prices in both the short and the long run, and, therefore, each set of prices yielded very different information. At the same time, there was a statistically significant relationship between the two; indeed, the relationship had proved to be much stronger than the staff had expected.

An important question was whether the relationship was sufficiently stable to be relied upon by policymakers, the staff representative continued. The staff had recently looked at turning points of inflation over the past 20 years. There had been six such turning points as shown by the aggregate consumer price index for the G-7 countries, including three peaks and troughs, the most recent of which was a peak of around 12 percent followed by a trough of a little more than 1 percent near the end of 1986. Of these turning points, five had been clearly revealed by turning points in the commodity price index that the staff had used--an export-weighted index that included gold and oil and which had a particularly strong statistical relationship with consumer prices. The sixth turning point, in 1978, had been contemporaneous with the turning point in commodity prices. The examination of turning points clearly showed that, over the 20-year period in question, there had been a tendency for commodity prices to lead consumer prices, at least in terms of the turning point in the movement of the aggregate consumer price index of the G-7 countries. Although the staff had noted in its paper a two-way causal relationship between long-term movements in consumer and commodity prices--in some periods, consumer prices had moved ahead of commodity prices, while in other periods commodity prices had moved ahead of consumer prices--there was a clear leader/follower relationship between the two sets of prices in terms of turning points in inflation. The staff's latest research had not shown a significant relationship between turning points in inflation and either money growth or unit labor cost growth.

One of the main issues at hand was the need to interpret the information provided by movements in commodity prices, the staff representative remarked. Commodity prices were known to change for a number of different reasons, ranging from the specific conditions in one or a few markets, to changes in the overall environment. The fact that commodity prices changed for a number of different reasons was a major problem in using the information provided by such changes. It was much easier to establish a relationship between commodity and consumer prices in retrospect over a 20-year period than it was to know how precisely to respond to a current change in commodity prices. The difficulty in interpreting commodity price information probably would always remain, but in all likelihood was no more serious than the difficulty in interpreting current data on monetary growth, unit labor cost growth, or other indicators.

In considering which indicators the Fund should look at in the future, the staff would certainly agree with Executive Directors who had stressed that the new indices that the staff had estimated in its paper were very preliminary in nature, the staff representative commented. The staff had been encouraged by the results of its inquiry in the sense that the new indices provided some additional understanding of the behavior of prices. At the same time, the staff fully agreed with Executive Directors who had emphasized that much more work was needed before any of the indices on commodity prices could replace or even supplement the present indices that were used as indicators. The staff would wish to examine further the question whether a commodity whose prices tend to be dominated by supply shocks should be excluded from a commodity price index; thus far, the evidence suggested that such an exclusion would probably prove to be unnecessary. Even such commodities as oil, coffee, and tea, whose prices changed frequently because of market conditions, seemed to be useful additions to commodity price indices. In addition, the staff would wish to explore Mr. Dallara's suggestion that the weight given to gold in a commodity price basket should be relatively large; under that approach, the weight would reflect gold's significant role in expectations rather than gold's small role in total trade and consumption.

In measuring inflation in the commodity price indicator exercise, the staff had chosen for the sake of convenience to convert all the price indices for both commodity prices and consumer prices into SDRs, the staff representative explained. The staff had recently come to have second thoughts about that approach. There appeared to be no ideal way in which to measure aggregate inflation in a group of countries where exchange rates moved relative to one another. At present, the staff was working on a method of measuring the exchange rate that was based on an aggregate exchange rate basket for the G-7 countries; that basket seemed to reflect the relative weights of the different countries in currencies more accurately than the SDR. The staff would wish to continue its work in that area in the coming period.

The staff had compared the usefulness of commodity price indices with the usefulness of other kinds of indices, such as indices of manufactured goods and monetary growth, the staff representative from the Research Department said. During its examination of normalized unit labor cost, the staff had felt that it was also examining the behavior of prices of manufactured goods as had been suggested by Mr. Salehkhou; the staff had felt that normalized unit labor costs tended to lead manufactured goods prices. At present, however, the staff felt that it would have been better to incorporate manufactured goods prices as a separate possible leading indicator, and the staff would study that possibility more closely in the coming period. The staff had been surprised to see that there had been no tendency for an aggregate monetary index for the G-7 countries to lead consumer prices. Mr. Enoch had usefully suggested that that outcome was possibly due to the fact that the various monetary aggregates were affected by exchange rate movements and by the differences in the kinds of monetary aggregates that were considered for individual countries. The timing of the availability of various kinds of data clearly worked much in the favor of commodity price indices. The indices of commodity prices discussed in the staff paper were available on a monthly basis, soon after the end of the month to which they applied.

Mrs. Filardo considered that the discussion had clearly shown that a commodity price index that was used as an indicator for policy coordination must be clear and simple. However, as the staff's explanations had suggested, each commodity price index would likely have to be interpreted differently and could send different signals. It might well be difficult for the staff to base its future work on commodity price indices on the varying signals that had been sent by the present discussion.

Mr. Nimatallah commented that the discussion had suggested that the Fund was concentrating more on statistical relationships than on economic relationships in the area of commodity price indicators; the Fund's work was concentrated on the technical and statistical level and could therefore be helpful, but perhaps also misleading. The statistical skeleton that had been developed should be fleshed out with meaningful economic implications. It was useful to note that, in the area of consumer and commodity price movements, certain two-way causal relationships were statistically significant, but it was also useful to consider the causes of the price movements themselves. For example, one cause could be the result of encouragement by certain factors, the reaction to which might well be excessive. It was important to consider the economic meaning of the conclusion that rates of change in commodity prices seemed to lead changes in consumer prices. Was such a conclusion helpful for the design and implementation of economic policy? At the same time, it was important to note the distinction between dynamic and static analysis based on commodity price indices. It was one thing to note the level of commodity and consumer prices in one year compared with another, but it was another thing to draw conclusions from that information on which policy decisions--for example, decisions aimed at stabilizing consumer prices in a coming period--were based. Great care had to be taken in moving from static analysis to dynamic analysis.

Even if a statistically significant relationship between commodity and consumer prices was evident, something that was certainly not obvious, the relationship that had been shown was a static one; commodity prices had to be seen in a medium-term or longer-term perspective, Mr. Nimatallah continued. A decision by an individual firm to purchase commodities might well be seen to be based on current market conditions, but such an analysis was less helpful in assessing the behavior of a large number of commodity prices in a single basket; after all, the price of each commodity would be affected by different supply and demand conditions. Industrial countries had been making a commendable effort to reduce their demand for oil and other commodities by making more efficient use of the commodities, and those efforts affected the prices of the commodities. It was on the demand for commodities that the Fund should concentrate its attention, and Mr. Enoch had usefully referred to the possible use of a broad index to detect changes in demand. Consumer prices provided a good indication of the behavior of demand, partly because they included the prices of manufactured goods. Each element of a broad index would have to be examined carefully and separately. Such basic matters would have to be fully examined before commodity prices could be relied upon to provide an early warning signal of inflation. He doubted whether such an early warning signal could be given, since commodity prices did not lead consumer prices.

The Chairman made the following summing up:

Our discussion was useful, I think, in identifying both the advantages and pitfalls of employing a commodity price index as an additional indicator for predicting aggregate inflationary developments in the large industrial countries.

A number of Directors felt that commodity price indices could play a helpful role in this context, as an adjunct to other indicators, and that their use could enhance the effectiveness of surveillance over the policies and performance of the larger industrial countries that have a major influence on global economic and financial developments. They pointed in particular to the property of commodity prices to lead movements in consumer prices. Such an early-warning signal could complement more traditional indicators of inflationary pressures by providing timely information that could help to foretell shifts in global inflationary pressures by providing timely information that could help to foretell shifts in global inflationary tendencies.

At the same time, I heard concerns expressed by many Directors regarding the possibility of relying too heavily on this type of indicator. These Directors emphasized that the relationship between commodity prices and consumer prices could not be deemed to be reliable enough to serve as the basis for guiding monetary policy in individual countries, that there have been periods when changes in consumer prices have lead changes in commodity prices--rather than the reverse--and that the long-run response of consumer prices to commodity prices could depart markedly from the short-run response. Some even questioned whether additional indicators of inflationary pressures were needed and, if so, whether an index of commodity prices would be the best choice.

As demonstrated in the staff paper, commodity prices have at times fluctuated greatly, while inflation of consumer prices has been much less volatile. This relationship points to the danger of assuming that stability of consumer prices would require stability of commodity prices. Furthermore, attention was drawn to the fact that the present level of commodity prices is quite depressed in real terms, even in relation to the long-run downward trend in the ratio of commodity to manufactured prices. Some Directors cautioned that if economic policies were, for example, to stabilize real commodity prices at the currently depressed level, serious adverse consequences for many developing countries would result. More broadly, these Directors also argued that the interpretation of commodity prices as indicators of future inflation should not lead us to neglect the role of these prices as indicators of conditions affecting developing countries that rely heavily on exports of primary commodities.

Various views were expressed on the question of whether the prices of petroleum and gold should be included in a commodity price index intended to serve as an indicator of inflationary developments. Because of the special nature of the oil market, the Fund's commodity price indices have, until now, excluded petroleum; oil prices have been extensively analyzed separately from those of non-oil commodities. Some Directors noted that the price of petroleum reflects conditions that are particular to that market, and that it therefore moves very differently from other commodity prices. Other Directors, however, observed that there appears to be a strong improvement in the predictive powers of the commodity price indices discussed in the staff paper when the price of petroleum was added to them, and they felt that it would be useful for the staff to monitor developments in these price indices.

The Fund has also always closely followed the market price of gold. Some Directors expressed the view that the price of gold is a sensitive barometer of changes in inflationary expectations and, as such, could make a useful contribution to a broadly based index of commodity prices. Other Directors argued that gold plays a relatively minor quantitative role in world trade and in consumption in industrial countries, and that its price is often dominated by supply developments. They felt that the addition of gold to a conventional index of commodity prices would therefore be of limited value, and could even be misunderstood as presaging a return to gold in the international monetary system. Of course, this difficulty could easily be diminished by providing appropriate information alongside the new index itself.

Many Directors noted that it was important to ensure that commodity price indices cover a broad range of commodities and that the weights be sensible from an economic perspective. Some Directors considered that the indices newly estimated by the staff, in which the weights assigned to each commodity are selected so as to give the best overall predictions of aggregate inflation, looked reasonable from this perspective. Some other Directors, however, questioned whether the weights in these indices could be interpreted as clearly as those in the more conventional indices in which the weights are based on the importance of each commodity in international trade or in consumption. These Directors also noted that the trade- or consumption-weighted indices that include the prices of gold and petroleum seem to predict inflation about as well as the newly estimated indices.

To conclude, I would judge that most Directors would support further work by the staff toward adding--perhaps on a trial basis--an index of commodity prices to the list of indicators that currently figure in the process of multilateral surveillance. As emphasized by most Directors, care would need to be taken to exercise judgment in the interpretation of such an index or indices--indeed, this goes without saying--in order both to extract the "signal" rather than the "noise" from commodity prices for future price developments, and to give commodity prices an appropriate weight as one among many indicators that correctly assist the surveillance process. I would propose that the staff continue to investigate this issue, with an eye toward resolving, if possible, the questions raised by many Directors during this day's discussion. As this work evolves and if the track record of commodity price baskets becomes better established, the staff could also consider giving somewhat more prominence to developments related to commodity price indices in the World Economic Outlook and in other Fund publications.

2. QATAR - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Qatar (SM/87/286, 12/3/87). They also had before them a background paper on recent economic developments in Qatar (SM/87/292, 12/16/87).

Mr. Finaish made the following statement:

Over the past few years, the primary focus of economic policy in Qatar has been, as it has in many other oil exporting countries, on the need to adjust to the substantial contraction of oil export revenues. This contraction was brought about by a slackening in the international demand for oil and the output restraint induced not only by that slackening, but also by an increase in the exports of non-OPEC oil producers. The repercussions of the sharply reduced oil export receipts were deeply felt throughout the economy as, closely parallel to changes in the oil sector's value added, economic growth declined in all but on year over the period 1981-86. Indeed, in 1986 alone, notwithstanding a 9 percent increase in oil production, the near halving of world market prices for oil precipitated a 21 percent decline in overall economic activity. In addition, largely due to the expenditure restraint necessitated by the decline in government oil revenues, but also due to the adjustment to more normal circumstances following the rapid growth and diversification in the decade up to the early 1980s, economic activity in the non-oil sector weakened. Reflecting this general economic slowdown, the demand for expatriate workers eased considerably, the domestic pressure on wages was sharply reduced, and rises in the cost of living index were limited to less than 2 percent annually over the past three years. As for 1987, the indications are that following the partial recovery of world oil prices, the oil sector recovered mildly while, reflecting the continued policy of fiscal restraint, the non-oil sector experienced a further, though moderate, contraction.

With government revenues in Qatar heavily dependent on income from oil and gas and with government domestic expenditures accounting for nearly 40-50 percent of GDP in recent years, the task of adjustment to the substantial decline in the country's oil export earnings in the 1980s was quite challenging. The authorities sought to strike an appropriate balance between the need, on the one hand, to limit international reserve losses and, on the other, to mitigate the contractionary impact on the economy of the fiscal restraint in the wake of the decline in government oil revenues.

As regards the fiscal restraint, total government expenditures were reduced throughout the period 1982-86, kept at approximately their 1985/86 level in 1986/87, and are expected to remain near that level in 1987/88, despite the projected recovery of oil revenue during the year. While this reduction in outlays was achieved by reducing, over most of the period of adjustment, both current and capital outlays, the relative contribution of the latter was much higher than that of the former, reflecting the completion of most of the necessary infrastructure by the early 1980s and the limited scope for further efficient diversification, as well as the need to meet the necessary spending requirements of essential social services and for the maintenance of capital projects. It is noteworthy that, in this environment of fiscal austerity, the authorities' recent decision to go ahead with the implementation of the highly needed first phase of the enormous offshore North Field gas project will have very limited budgetary implications. Also noteworthy in this regard is the authorities' intention to continue their external assistance program, albeit at a reduced level in comparison with their aid flows during periods of stronger fiscal and external payments positions.

Even though reductions in government expenditures have been substantial, they were not sufficient to offset the more rapid declines in government revenues in the 1980s. As a consequence, though government outlays were about 15 percent lower in 1986/87 than their already reduced level in 1984/85, the much sharper contraction of government revenues over that period moved the budget from a surplus to a large deficit in 1986/87. The budget deficit is expected, on account of the projected recovery of oil revenues during the year, to decline somewhat in 1987/88, with the needed financing expected to be secured by a drawdown of the Government's domestic and foreign assets. It is to be noted in this regard that in the event of future declines in government oil revenues, the authorities are prepared to give consideration to alternative revenue measures, such as the introduction and extension of user fees for government services. As for tax initiatives, the authorities consider that the scope for such initiatives is currently limited by administrative difficulties, as well as social and economic constraints. Additionally, consideration of potential revenue-broadening measures in Qatar need to take into account regional revenue arrangements and the free factor mobility within the Gulf Cooperation Council (GCC) region.

As regards recent policies and developments in the monetary field, notwithstanding their finding that none of the commercial banks faced any major risks, the authorities implemented a number of measures aimed at strengthening bank supervision and preserving the soundness of the banking system. These measures included the introduction of reserve and capital requirements and proposals by the Qatar Monetary Agency (QMA) calling on banks to provide for doubtful loans and improve the quality of their portfolios. In addition, the QMA also introduced a new discount facility with the aim of enhancing its role as a lender of last resort. The rate of monetary growth of about 10 percent in 1985-86 represented a marked decrease from the 22 percent rate in 1984, and prevented a loss of foreign reserves beyond a level regarded as acceptable by the authorities. The monetary growth rate is projected to decline further to 7 percent in 1987. Also, following two years of rapid expansion, the growth of credit to the private sector slowed down considerably in the first half of 1987.

Developments in Qatar's external position during the period 1984-86 largely reflected the adverse impact of the sharp decline in oil export receipts. These developments also reflected the impact of a number of mitigating factors, such as a reduction in private capital outflow, an improvement in investment income, and a contraction of imports. Balance of payments estimates for 1987 envisage a recovery of exports, as well as a further contraction of imports. The Qatari riyal has depreciated in line with the U.S. dollar since early 1985, and Qatar's trade system has continued to be liberal, with import duties at the lower end of the agreed GCC range, which itself is relatively low.

The medium-term projections for Qatar's balance of payments are, as illustrated by the alternative scenario reported on page 13 of the staff report, highly sensitive to developments in world oil markets. However, even under the pessimistic assumptions underlying that scenario, it appears that Qatar's international reserves are sufficiently large to afford the authorities considerable room for maneuver. In any event, the authorities fully intend to continue to be responsive to developments in the oil market while maintaining an environment conducive to the resumption of normal growth.

Mr. Al-Assaf made the following statement:

In the two years since the previous consultation with Qatar, the authorities have continued to implement their policy of economic and financial adjustment. The fall in export receipts from their 1981 peak made this adjustment unavoidable, as Mr. Finaish explained in his opening statement. Although the adjustment has been made easier by the sound initial financial position of the country, it would be incorrect to assume that this adjustment has been painless.

The authorities should be commended for their prudent management of the economy. Government spending, in particular, has been kept at a level that strikes the right balance between two main considerations: on the one hand, that government expenditure should be adequately supportive of economic activity; on the other hand, that expenditure should remain consistent with a sustainable rate of reserve use. The comfortable level of reserves demonstrates the prudence of the authorities' management of the economy. However, the income generated by these external assets will not be sufficient to prevent their drawdown, even at present levels of reduced expenditure. This clearly illustrates the limitations of foreign investment as an alternative to the diversification of the domestic economy.

In this context, the authorities have already made some decisive moves to broaden the productive base, particularly, the cement, steel, and petrochemicals industries--most of them government owned. The broadening of the productive base is the basis for the future development of other downstream industries which are essential to economic development. In view of the significant competitive advantage enjoyed by Qatar in these industries, such efforts should be encouraged.

A key to the success of such diversification is free access to external markets. In this respect, the experience of the Gulf Cooperation Council (GCC) countries, including Qatar, has not been very positive so far. The GCC countries will continue to address this issue in the context of their negotiations with their economic partners, especially countries that were members of the European Communities (EC).

On the whole, the staff report provides a fair assessment of the adjustment process being implemented by the authorities. It also recognizes their efforts to continue their program of external assistance, despite the weakness of the external position. On both counts, the authorities deserve the commendation of the Board.

Mr. Comotto made the following statement:

I endorse the staff's appraisal.

In considering Qatari economic policies, it is of course important to bear in mind the considerable flexibility afforded by Qatar's substantial reserves, which is highlighted by the medium-term projections in the staff report. I am sure, however, that the authorities are not seriously considering actually using up the room for maneuver available to them. Therefore, the need identified during the previous Article IV consultation to continue adjusting to sharply reduced oil export earnings, by enhancing non-oil revenue over the medium term and containing expenditure, particularly on subsidies, still holds true. This point must be emphasized, as the scope for further significant cuts in government expenditure is felt to be limited by social and economic objectives. I welcome the fact that the authorities have taken further action to control expenditure in some areas, by reducing the number of subsidized products and through the planned rationalization of incentives and services provided to agriculture. On the revenue side, their willingness to consider charging for government services is a sensible precaution, and they should perhaps examine the scope for increasing import tariffs. Prudent external borrowing may be helpful. Ultimately, however, the sustainability of the authorities' current decision not to undertake any "major initiatives" on the revenue side will clearly depend on external developments. In the longer term, there are also cogent structural reasons for phasing out subsidies and applying economic charges to services.

In a longer-term perspective, it is clear that Qatar, in common with its GCC partners, faces important developmental challenges. There appear to be inherent limits on agriculture and on oil and gas-related manufacturing activities. It is not clear where Qatar's comparative advantages lie outside the energy sector and related industries. The suggestion that comparative advantage lies in small and medium-term projects in the private sector that are aimed at the GCC market seems reasonable, although it would be interesting to know precisely what sort of activities are envisaged. Another area may be regional commerce. The Gulf Cooperation Council should provide an important framework within which Qatar and its Gulf partners can mutually foster their development and diversification. Perhaps, Article IV consultations for countries in this region could explore this perspective in the future; such an approach might usefully flesh out a report that is rather thin, particularly as it is produced only biennially.

As to more immediate issues, I especially welcome the authorities' actions to strengthen banking supervision, including the introduction of reserve requirements for bank deposits and minimum capital/asset ratios. I also endorse the staff's call for early adoption of a policy on provisioning for bad or doubtful debts. The development of the Qatar Monetary Agency's role as lender of last resort is sensible, but the effectiveness of its discount window as an instrument in extending crucial liquidity to the financial system appears to require some development of the market in eligible securities. Indeed, there appears to be scope for more general development of the financial system in order to improve the intermediation of Qatar's financial resources; in this respect, Qatar might find it worthwhile emulating some of its GCC partners in establishing a treasury bill market. Such a step could also be helpful in facilitating public sector financing.

I strongly urge Qatar to attack the serious deficiencies in its statistical base. This problem is unfortunately all too common for the Fund. Still, Qatar has an admirable record of cooperation in other areas--most commendably, it has maintained an open exchange and trade system despite the volatility of its external economic environment. I hope that the authorities will seek to address the statistical problems very soon.

Mr. Kabbaj made the following statement:

I broadly agree with the staff appraisal. During the previous consultation with Qatar, the Board commended the authorities for following appropriate policies to adjust the economy to the sharp drop in earnings from oil exports. It is heartening to note that the recommendations of the Board regarding budgetary and monetary policies were largely taken into account by the authorities in managing their economy.

Qatar, like other oil producing countries, has indeed suffered during recent years from the downturn in the oil markets. Given the preponderance of oil and gas in the Qatari economy--they account for 85 percent of export receipts and more than one half of government revenues in 1986--the effects on the economy of the oil market downturn could have been much greater; indeed, as pointed out in Mr. Finaish's opening statement, economic growth declined in all but one year over the period 1981-86. Oil export earnings declined sharply over the period and, consequently, the external current account turned negative in 1986, while the overall balance of payments, which recovered somewhat in 1984 and 1985, also turned negative, by about $500 million, in 1986.

Fortunately, the small size of Qatar and of its population, as well as the comfortable level of reserves and the conservative budgetary policies implemented in reaction to the downturn in oil prices, mitigated the adverse effects of the oil price situation. The non-oil sector was affected by oil sector developments and the budgetary restraint that accompanied it. I basically agree with the authorities that the situation in the non-oil sector reflects the adjustment of the economy to more normal circumstances--including lower oil prices--especially as the bulk of the infrastructure, except for the energy and water sectors, has been completed.

On the medium-term prospects, the authorities do not feel that they should embark on any major initiative at this time, but I encourage them to consider the staff recommendations--as they seem to do--as a precautionary set of measures that they can usefully implement should any adverse development warrant it. In this connection, I note Mr. Finaish's assurances that "in any event, the authorities fully intended to be responsive to developments in the oil market while maintaining an environment conducive to the resumption of normal growth."

Given the size of the Qatari economy and population, and the more than comfortable level of reserves and the strong adjustment policies that have already been implemented, there are no foreseeable problems with the reserves. Moreover, as the simulation by the staff shows, even if oil prices were below their projected level by $5 per barrel and capital outflows were much higher, the level of reserves would be sufficient to cushion Qatar until the end of 1990.

I commend the authorities for maintaining an open trade system and for the level of their official development assistance.

Mr. Templeman made the following statement:

Despite the very important external developments that have occurred in the two years since the Board last reviewed economic developments in Qatar, the nature of the economic adjustment problem facing the authorities has not changed. The need to diversify the economy in order to reduce the country's vulnerability to the vicissitudes of the world oil market and to create alternative sources of growth remains the principal issue. The sharp drop in oil prices in mid-1986 and in late 1987 has underlined the importance of this objective. While these developments have added a degree of urgency to the need for policy measures, the authorities have been making quite good progress in their adjustment and reform efforts.

The brunt of the adjustment effort has fallen on the fiscal accounts and, importantly, on a scaling back of expenditures--by an impressive 16 percent in nominal terms between 1983/84 and 1987/88. The staff report notes that subsidies have been reduced and that further cuts in subsidies will be contemplated if the budget situation deteriorates. However, I wonder why action in this area should not be taken in any case. On the revenue side, petroleum revenues have declined by nearly 50 percent between 1983/84 and 1987/88. It is therefore surprising that, while recognizing the utility of broadening the revenue base, the authorities do not plan any major initiatives in that area in the foreseeable future. Although Mr. Finaish touches on this question in his opening statement, I would welcome further comment on it.

Good progress has also been made in adjusting the external accounts to the lower oil receipts. The current account balance worsened between 1982 and 1987 by only about $1.2 billion, in the face of a decline in oil exports of $2.4 billion. While much of the correction has taken the form of a compression of imports, this does not seem to pose a threat to real economic growth, since the completion of infrastructural projects has reduced the need to maintain a high import level. The other major factor in protecting the balance of payments position has been the sharp drop in private capital outflows, by more than $1 billion between 1982 and 1986, including errors and omissions. No doubt this reflects, in part, relative interest rate changes in Qatar and abroad. Over the medium term, it appears that there is little likelihood of serious problems arising in the external accounts, because of the large cushion of reserves.

While the staff report stresses the importance of the fiscal accounts in the adjustment effort and notes the relatively limited role of monetary policy, it does alert us to the potential for some shift in the relative importance of these tools of economic management.

For example, the leveling off of fiscal expenditures, the potential effects on capital flows arising from the spread between interest rates in Qatar and abroad, and the need to preserve the soundness of financial institutions, all suggest that some more attention should be paid to monetary policy. In this connection, I welcome innovations in the form of reserve requirements, capital and reserve ratios, and the new discount facility. I also endorse the cautionary note about the possible need to use interest rate policy more actively, should international interest rates rise so as to create an incentive for capital outflows.

Like Mr. Comotto, I wish to underscore the inadequacy of Qatar's statistics and the need to improve them. For example, except for the medium-term balance of payments outlook, there are no data for 1988, and, even for 1987, the data are limited to the balance of payments and 1987/88 budget figures. I wonder if it would not have been possible to present at least a few more up-to-date estimates of additional variables.

Mr. de Groote said that he agreed with the staff's assessment of the situation in Qatar and noted that the staff's views were similar to those of Mr. Finaish. The discussion of the exchange rate system was somewhat confusing in the staff report, and was especially so in the background paper, where, in the first paragraph on page 41, the Qatar riyal was said to be pegged to the SDR, but in the following paragraph was said to be pegged to the dollar. Given those statements, and Mr. Finaish's comment that the Qatar riyal had depreciated in line with the dollar, it seemed that the peg to the SDR was only a formal peg, and that the Qatar riyal was actually pegged to the dollar. Was the actual peg of the Qatar riyal to the dollar advantageous or not? It appeared that the present sharp depreciation of the exchange rate, in line with the fall in the dollar might retard the further development of the country, because imported inputs were badly needed. As more than half of GDP did not result from oil production, it might be advantageous for the authorities to, in practice, peg the exchange rate to the SDR instead of the dollar.

Chart 2 of SM/87/292, indicated that interest rates in Qatar had remained unchanged, while the LIBOR rate had fluctuated greatly, Mr. de Groote observed. The staff papers noted that the constraints of the sharia principles explained the static interest rates. However, he wondered whether the staff was sure of its judgment on the interest rate situation; as he understood it, the rate on foreign exchange deposits was completely flexible and followed the LIBOR. Anyone in Qatar who was interested in exporting or importing capital was probably sophisticated enough to maintain deposits denominated in foreign exchange, in order to have the full benefit of the fluctuation in the relevant interest rate, but the flexibility of the deposit rate probably affected only those segments of the population that were relying on more traditional banking forms. If so, the staff's strong recommendation for important changes in the interest rate system in Qatar was inappropriate. The present situation was acceptable because the capital movements that could affect the balance of payments were already subject to fluctuating interest rates, while the fixed rates generally did not affect capital outflows.

Improvements in the statistical base were needed, and the Qatari authorities' official development assistance was commendable, Mr. de Groote concluded.

The staff representative from the Middle Eastern Department said that the staff was not well equipped to take an in-depth look at individual industries and sectors to examine the potential for diversification. Such studies were normally undertaken by the World Bank. While the Fund staff did not have the benefit of recent reports or studies by the World Bank on

Qatar, studies were available from the Bank on sectors in neighboring countries in similar situations to Qatar's; accordingly, it was thought that Qatar's comparative advantage would be in small-scale, capital-intensive industries. However, one should not become too optimistic; in the view of the staff, Qatar, like other countries in the region, had distinctly limited scope for further diversification.

As to what one speaker had called the thinness of the staff report, the staff representative said that the shortage of statistics had posed a major constraint on the preparation of the report. Moreover, since Qatar faced few problems it was felt that a succinct report was warranted.

The potential for expanding the budgetary revenue base had been discussed with the authorities, the staff representative noted, but it was not felt that any decisive steps toward revenue diversification were imminent, although the authorities were giving thought to introducing charges for some public services as a contingency. The authorities, like those in neighboring countries, faced a dilemma, because current recessionary conditions made it politically difficult to launch revenue initiatives. On the other hand, when economic conditions had been more favorable, including higher oil prices, there might have been enough political leeway to introduce revenue diversification measures, but the economic need for such steps was not pressing. Perhaps for that reason, Qatar, like other countries in the region, had tended to miss the opportunity for expanding revenues. The staff had, however, encouraged the authorities to look closely at their options in that area, particularly as the authorities saw the scope for further cuts in government expenditures as quite limited.

The exchange rate peg to the SDR was, as Mr. de Groote had observed, purely formal and had no practical significance, the staff representative said. The Qatar riyal had, in practice, been pegged to the dollar for about seven years; a number of the countries in the region had found it to be a convenient arrangement. Certainly the peg to the dollar over the past few years had not been in conflict with the weaker external position associated with the decline in oil prices and the greater emphasis on diversification; indeed, the incentive for the production of domestic goods had been rising sharply. Of course, import prices had risen, but the rise was consistent with the authorities' desire to restrain imports and to meet their reserve target.

The scope for interest rate policy was limited, the staff representative from the Middle Eastern Department remarked. Nevertheless, interest rates could play a supplementary role in the general stabilization effort. Although it was true that foreign currency deposits were free of interest rate ceilings, the authorities were apprehensive about the possible re-emergence of interest differentials in favor of world capital markets and the possibility that it would promote capital outflows. While the staff did not wish to overplay that issue, it was believed that a more flexible interest rate policy could be helpful, considering both the openness of Qatar's capital market and the desire to achieve a specific reserve target with a given budget posture.

Mr. de Groote remarked that, while the depreciating dollar might have benefited Qatar, by protecting manufacturing industries, and might not have harmed the country through a rise in the cost of imports--conclusions that he did not necessarily accept--he wondered whether Qatar enjoyed any advantages from a strong appreciation of the dollar.

The staff representative from the Middle Eastern Department said that it was likely that, when the dollar had appreciated, domestic industries had been hurt. But the appreciation had occurred largely prior to the time when oil revenues had begun to decline and, therefore, at a time when the economy could better withstand it. An important question was whether a continued link to the dollar into the future would be beneficial. In that connection, the authorities--conscious of the need to ensure domestic competitiveness and to promote whatever further efficient diversification was possible--should keep their options open. A recent proposal to introduce a common pegging arrangement in the Gulf Cooperation Council had been shelved for the time being, the staff representative noted, and the exchange rate question might well become an issue in the period ahead.

Mr. Finaish remarked that Qatar's situation was clearly similar to that of other countries in the region that had been affected by the drop in oil prices. Over the period 1982-86, oil and gas production accounted for 44 percent of Qatar's GDP, 90 percent of merchandise exports, and 83 percent of government revenues; therefore, the sharp decline in the country's oil export receipts--brought about mainly by a weakening in the international demand for oil--had serious implications for the balance of payments and the government budget. Moreover, in the case of Qatar, there was an additional, highly significant dimension to the adverse impact on the country of the weakened international demand for oil and the output restraint induced by the weakened demand, as well as the increase in the exports of non-OPEC oil producers. Nearly all of Qatar's infrastructure depended importantly on associated gas, as did the various petrochemical plants that had contributed significantly to the diversification away from simple crude oil production and export--about 40 percent of Qatar's total gas supply of approximately 600 million cubic feet per day in 1986 comprised associated gas. On the other hand, domestic demand for gas had risen by about 10 percent annually over recent years. The decline in the supply of associated gas--because of falling oil production--together with the decline in the flow of nonassociated gas--because of falling pressure in the Khuff reservoir--led to frequent power interruptions, which turned out to be costly to some of Qatar's major manufacturing plants. The country's fertilizer and petrochemical industries were especially adversely affected by the decline in gas supply, as they relied on gas not only for fuel, but also for feedstock.

It was fair to say that Qatar had managed the adjustment well, Mr. Finaish added. Over the period since the previous Article IV consultation discussions with Qatar, oil receipts declined by about QR 5 billion, while the overall balance of payments deteriorated by only QR 3 billion, moving from a surplus of QR 1.2 billion in 1984 to a deficit of QR 1.8 billion in 1986. The thrust of the adjustment came from cuts in government expenditures which, albeit substantial, were not sufficient to offset a much sharper decline in government oil revenue. As might be expected, activity in the non-oil sector, which depended heavily on domestic government expenditures, was seriously affected. Nevertheless, adjustment had been achieved without resort to restrictions or artificial support of the domestic economy and, despite the difficulties it experienced over recent years, Qatar continued to be a source of sizable foreign assistance. Furthermore, workers' remittances from Qatar continued to contribute significantly to the foreign exchange earnings of a number of countries in the region.

The authorities recognized that more attention should be paid to the statistical data base, Mr. Finaish said. As to interest rate policy, the Qatar Monetary Agency's banking control department was in the process of preparing a study on the domestic interest rate structure. He did not believe that interest rates could play a major role in adjustment, given the circumstances and constraints in the region, as had been observed by Mr. de Groote. Whether it was the interest rate differentials which played the major role in the capital outflow of foreign deposits, as Mr. de Groote had mentioned, was not clear, although the authorities were certainly studying the matter. One reason why the authorities were thinking about the issue was that, given the openness of Qatar's capital market and a reserve target, an unfavorable interest rate differential could impose a need for greater restrictiveness in fiscal policy.

The questions of the benefits of pegging the Qatar riyal to the dollar and the extent to which the exchange rate was an important factor for diversification were relevant, Mr. Finaish considered. However, the peg to the dollar over recent years had not been counterproductive, as the incentive for the production of domestic goods had risen sharply and the contraction of imports was in line with the authorities' desire to prevent a rapid drawdown of foreign reserves. Whether the peg to the dollar would continue to be beneficial in the future was a matter that should be considered in light of developments in the exchange rates of major currencies, as well as the exchange rate arrangements in the region.

As to the question of broadening domestic revenues, the staff was correct in noting that there was a cyclical dilemma, because the politically feasible time for increasing and broadening domestic revenues--when the economy was strong--did not coincide with the need for increased revenue, Mr. Finaish agreed. Although it was currently politically difficult to broaden revenues, the authorities were prepared to consider adopting user charges on government services in the event of future declines in oil revenues, but they were justifiably more hesitant about taxing income, considering that their neighbors had not done so. It would be difficult to consider tax initiatives in Qatar without taking into account the regional revenue arrangements and the free factor mobility within the GCC region. However, Directors had emphasized that it was important for the authorities to make a start on the issue of broadening revenues, particularly in view of the administrative delays involved in the implementation of new tax measures.

As to the most appropriate path to follow in the future, Qatar had built a sophisticated infrastructure and had established some oil-based industries along the lines of its comparative advantage, Mr. Finaish remarked, but he wondered whether there was an adequate market for its non-oil exports. It was useful for the staff to address this issue in a regional context, meaning within and beyond the Gulf Cooperation Council.

The Chairman made the following summing up:

Executive Directors concurred with the conclusions and policy recommendations in the staff report for the 1987 Article IV consultation with Qatar. Directors commended the Qatari authorities for their continued sound management of the economy. Sustained adjustment to lower oil revenues has been achieved primarily through restraint in budgetary expenditures, with the result that the deterioration in the external position has been contained and official reserves have remained at a very comfortable level. Directors also welcomed the steps taken in the monetary and regulatory fields, mainly with a view to preserving the soundness of the banking system. Despite the persistence of recessionary conditions and falling employment in the non-oil sector, the authorities have wisely avoided recourse to increases in subsidies or protectionist measures.

Qatar's strong external reserve position, in the opinion of Directors, put the country in a good position to cope with the continued uncertainties in the world oil market. Nevertheless, in view of the stated goals of the authorities, namely, to avoid both large reserve drawdowns and further major cuts in government spending, Directors agreed that it was timely for the authorities to consider new measures to broaden the fiscal revenue base. They also endorsed the continuing efforts of the authorities to broaden the economy's productive base in collaboration with their Gulf Cooperation Council partners and, in that connection, the need for adequate access to foreign markets was emphasized. The Qatari authorities were also encouraged to keep under review the appropriateness of their exchange rate regime. Directors commended the authorities for continuing their external assistance program in spite of the weakening of the external position. They urged the authorities to press on with their efforts to strengthen the data base, as some deficiencies have been observed in it.

It is expected that the next Article IV consultation with Qatar will be held on the 24-month cycle.

3. BURKINA FASO - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Burkina Faso (SM/87/295, 12/16/87). They also had before them a statistical annex (SM/87/299, 12/31/87) updating the previous year's background paper on recent economic developments in Burkina Faso (SM/86/168, 7/9/86).

Mr. Mawakani made the following statement:

> The staff report for the 1987 Article IV consultation with Burkina Faso provides a fairly accurate description of economic and financial developments in 1986. It also gives a good indication of the trend in major economic indicators in 1987. However, the paper does not give adequate credit to the authorities' resolute efforts to reduce the financial imbalances confronting the Burkinabè economy and to move it to a sustainable growth path. It should be mentioned that since 1984, the authorities have been implementing strong austerity measures, including measures aimed at raising government revenues in order to restore viability in government finances. Moreover, as described below, these policies have yielded positive results on many fronts. While economic and financial developments, as reported by the staff, were influenced by improved weather conditions in 1986, it is fair to recognize that the policies pursued by the authorities also contributed to these developments.
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> The strong economic growth recorded in 1985 was sustained in 1986, with real GDP estimated to have grown by 10 percent. Inflation, as measured by the consumer price index, turned negative, and the operations of the Treasury on a commitment basis, after virtual equilibrium in 1985, registered a surplus representing 1.7 percent of GDP. Moreover, the external current account deficit, including official grants, was reduced to 3.4 percent of GDP, and the overall balance of payments recorded a substantial surplus allowing for a reserve buildup representing five and a half months of imports of goods and services.
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> Available data for 1987 point to a continued upward trend in real GDP growth, a downward trend in prices, and a further strengthening of the external position--with gross official reserves at the end of 1987 estimated at 6.4 months of imports of goods and services. However, because of a doubling of domestically financed investment outlays and a less buoyant revenue performance than in the previous fiscal year, the government budget is expected to shift from the surplus recorded in 1986 to a deficit amounting to CFAF 6.5 billion, or 1.3 percent of GDP. All in all, despite unfavorable developments in some of the financial indicators, Burkina Faso's economic performance in 1987 is estimated to have been satisfactory.

Instrumental in bringing about the results of the last two years was a series of measures, most of which go in the direction recommended by the Executive Board at the conclusion of the 1985 Article IV consultation.

In their efforts to move the economy toward a sustainable growth path in the medium term, the Burkinabè authorities in August 1986 launched a Five-Year Development Plan covering the period 1986-90. Among other objectives, the Plan seeks to achieve self-sufficiency in food over the medium term, protect the environment, provide adequate social services, and improve the basic infrastructure. To facilitate the implementation of the Plan, the authorities initiated steps to strengthen the planning, execution, and monitoring of public investment projects. In this vein, a unit vested with the task of establishing a data bank to standardize and centralize information to assist in project implementation was created. In addition, they are seeking World Bank assistance in the formulation of ta three-year rolling investment plan. The authorities hope that these actions will address some of the problems identified in this area.

With regard to pricing and marketing policies, and as was made clear to the staff mission, the authorities' main concern is to protect the purchasing power of the population and ensure the availability of basic consumer goods. It should be stressed that the system of price controls in place is being implemented flexibly, allowing for timely price adjustments. An example of this type of flexibility is the halving of the producer prices for cereals during the 1986/87 crop season when the bumper crops harvested led to a significant drop in cereal prices. This courageous action was taken to alleviate the financial burden experienced by the cereal marketing agency, OFNACER. In order to encourage domestic production and reduce the import bill, the authorities have stipulated that cereals should be used increasingly as inputs in the production of some domestic goods. Although this requirement is seen by the staff as a means of reinforcing marketing control, it should be pointed out that the authorities view this measure as a means of promoting consumption of local raw materials. It should also be noted that the ban on imports of fruits referred to in the staff paper was lifted in early November 1987. The authorities are satisfied with the pricing and marketing arrangements in place, but are keeping them under close scrutiny to make them more flexible, if warranted.

In the fiscal sector, the improvement in the budgetary position in 1986 is attributable to the sharp increase in government revenue, resulting from the introduction of taxes on petroleum imports and on rental income, the strengthening of the customs administration, and a better collection of income taxes.

More importantly, as a general policy, the civic duty of paying taxes was promoted and efforts were made to collect tax arrears. On the expenditure side, measures to restrain current expenditure growth and to enhance expenditure control were maintained.

Regarding the public enterprise sector, the authorities are aware of the difficulties facing this sector and are determined to tackle them. As indicated in the staff report, actions were taken in 1986 and 1987 to that effect. The fares of the bus company were increased, and private sector participation in the capital of some enterprises was encouraged, leading to a change in the status of four enterprises from public to mixed. Additional measures taken include the establishment of a management reporting system--with World Bank assistance--to provide clear and timely information on the overall performance of the public sector, and the introduction of a new wage scale that will significantly cut the wage bill of public enterprises. Higher salaries will be awarded only by enterprises that perform well.

In the external sector, in spite of the substantial deterioration of the terms of trade in 1986, the current account position showed an improvement. This was due to the authorities' efforts to expand activities in the mining sector--gold exports nearly doubled--broaden the export base of the economy, and promote the consumption of local raw materials and locally produced goods. Indeed, total exports increased by about 11 percent while total imports in CFAF terms decreased slightly. Despite these favorable developments, the Government's ability to service its external debt was constrained by the unavailability of timely budget revenues and by weaknesses in the management of the external debt. The authorities are still considering the creation of an autonomous sinking fund, a move that will help resolve some of the difficulties being encountered in this field.

To conclude, it should be recognized that over the past several years, the Burkinabè authorities have made strenuous efforts to come to grips with the financial difficulties confronting their country. They feel that their adjustment efforts did not always attract the external financial support they deserve. In any event, they are aware that the progress achieved over the last two years remains fragile, and are conscious of the need to develop a full-fledged adjustment program to put the economy back on a sustainable noninflationary growth path. They look forward to working with the Bretton Woods institutions and the international financial community to help them achieve their goals.

Mr. Rousset made the following statement:

Despite the weakness of the available statistics, the staff report contains enough information to point out the perceptible deterioration of the financial situation--mainly in the budgetary sector--which occurred in 1987. The deterioration took place despite the implementation of several courageous measures by the authorities over the past two years. I fully agree with Mr. Mawakani's opening statement: credit must be given to the authorities for the efforts they have made in such areas as the enhancement of budgetary revenues and the control of the wage bill. The progress made in the cotton sector is also worth mentioning. It is interesting to note that Burkina Faso is the only country that has made the difficult decision to reduce the producer price of cotton. Some progress has also been made in the preparation of a public investment program for 1988, and the design of a management reporting system for the public enterprise sector seems well under way.

While I recognize the seriousness and courage of the authorities in implementing these measures, it is worrisome that they did not achieve better results. The gap between these efforts and their effects may stem largely from the lack of a general strategy, which would have ensured overall consistency between objectives and constraints. The weakness of the statistics and the lack of coordination between ministries also had a significant effect on this outcome.

However, given the recent change in government, I will focus more on future prospects than on analyzing last year's events. The authorities' determination to strengthen their dialogue with the Bretton Woods institutions, as Mr. Mawakani stated in his opening statement, was very encouraging. Indeed, these institutions could provide valuable assistance to the authorities in their task of elaborating general, medium-term strategies.

The medium-term framework is clearly a prerequisite for designing an adequate public investment program, and for evaluating the role of public enterprises and the authorities' choices in trade and pricing policies. I am pleased with the attention the authorities are giving to the medium-term framework issue; I encourage them to go ahead, with the support of the Fund and the World Bank. Clearly, attention to the medium-term framework is the role assigned to the policy framework paper exercise--namely, to draw up a strategy and to design measures and a time schedule consistent with the strategy.

In addition, Burkina Faso will require increased amounts of external assistance. The conclusion of an arrangement under the structural adjustment facility will certainly play a crucial role in the mobilization of additional assistance, including that of the World Bank.

The World Bank should be able to provide some helpful support. In contrast to 1986 and 1987, 1988 should witness the approval by the Bank of several important projects. In this respect, I note the significant projects related to the transport sector, agricultural research, agricultural extension services, the urban sector, and several other areas which could be approved in 1988.

Moreover, a World Bank mission, aimed at deepening the policy dialogue with the Government, is scheduled for next February or March. In order to initiate studies for a policy framework paper, it would certainly be useful if the Fund could participate in the mission.

Mrs. Walker made the following statement:

My comments on the Article IV consultation with Burkina Faso can be brief for two reasons: the report may not reflect the economic policy plans of the new Government; and, more important, there is little statistical information on actual developments in the economy in 1987. As Mr. Rousset indicated, it is clear from examining the general trends in the data in the report that certain areas in the economy need immediate attention.

The first and foremost area requiring attention was the statistical one. It appears that Burkina Faso has a very weak statistical base. Not having much data on developments in the past year, it is difficult for us to make any accurate determination or analysis of economic developments, or to estimate future trends. The authorities should request statistical technical assistance from whatever sources might be available, including the Fund.

Second, I see several major problems in the fiscal sector. The extrabudgetary outlays need to be incorporated into the budgetary process. I urge the authorities to adopt a consolidated government budget and to include the deposits of the government and the public sector agencies in the budgetary control process.

Another problem is the weak financial position of the public sector enterprises. I welcome the establishment of a management reporting system with the World Bank and the introduction of a new wage scale. In addition, a medium-term plan for the rehabilitation of public enterprises should be developed, particularly in light of these enterprises' apparent drain on the fiscal sector.

The authorities should also develop, in conjunction with the World Bank, a realistic investment program--one that takes into account its effect on the fiscal and the balance of payments positions. In my view, only viable and essential projects should be undertaken, particularly in light of the need to curb the deficit by greater amounts than are currently projected, and to avoid a financing gap and a possible further accumulation of arrears.

Monetary policy should complement the tighter fiscal policy. I welcome the authorities' commitment in this regard, but I am unsure whether the measures taken thus far are the most efficient means of implementing a tighter monetary policy.

The present system of price and marketing controls is not as efficient and flexible as a free-market system could be. I would not be surprised if rigidity in pricing and marketing policies did contribute to the weak performance of the secondary sector of the economy, as well as of the public sector enterprises, and I urge the authorities to consider liberalization in this area.

Improvements in the statistical base of Burkina Faso are needed so that consultations as well as economic planning, could be based on at least a minimal level of knowledge about economic performance. Such a statistical base is required to develop a more comprehensive economic package that could help the authorities to obtain needed financial support. I encourage the authorities to take this opportunity to create such a program.

Mr. Goos said that he also found it difficult to comment on economic developments in Burkina Faso in the absence of information on the policy intentions of the new Government. Nevertheless, the staff report revealed several weaknesses in the economy that warranted attention and prompt action, despite the emergence of several encouraging trends in the economy, which were described in Mr. Mawakani's opening statement and which no doubt could be attributed largely to the adjustment efforts of the authorities.

The continued accumulation of external arrears and the rather bleak outlook for the external current account were clear causes for concern, Mr. Goos considered. As the staff suggested, the authorities should try to raise domestic savings by strengthening the fiscal position, and they should include in that effort the rehabilitation of the public enterprise sector. The staff's advice to liberalize the pricing and marketing system, in order to improve the efficiency of resource use, was also appropriate. The existing, rather favorable external environment provided a good opportunity to make relatively easy progress in the fiscal and public enterprise areas.

The staff's recommendations to improve the statistical data base for the planning, implementation, and monitoring capacities of the Government were correct, Mr. Goos observed. Serious shortcomings in those areas went a long way toward explaining the existing economic problems, notably the continued worrisome accumulation of external arrears. Substantial progress in improving the statistical data base was also a prerequisite for the successful implementation of any Fund-supported adjustment program. As Mrs. Walker had suggested, Burkina Faso should make greater use of the technical assistance provided by the Fund and by other institutions, although given the experience with such assistance in the recent past, it would only be useful if it coincided with a willingness by the authorities to implement the recommendations made. He supported the staff appraisal.

Mr. Comotto agreed with the other speakers that the weak statistical base was a cause for increasing concern, and that a solution to the problem was a prerequisite for the approval of a Fund-supported program.

Mr. Hogeweg made the following statement:

> The staff analysis is clear, and the recommendations are entirely appropriate. It is my impression that the authorities have insufficient statistical information on their economy to enable them to formulate a comprehensive policy package. I note especially the footnote on page 2 of the staff report that says that the quantification of economic variables is only indicative of underlying trends. Indeed, there might be a link between the unavailability of economic statistics and the fact that the authorities tend to resort to administrative measures rather than market-oriented policies--there is indeed a greater chance to encounter surprises when the authorities have no accurate information on what is going on.
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> There have been large swings in the Central Government's finances. Apparently, these swings are due partly to the statistical treatment of some budgetary items. On page 4 of the staff report, it is mentioned that the 1985 wage bill was lower because one month's pay was withheld to finance public investments. In 1986, the wage bill was also inflated by the inclusion of salaries withheld for the financing of investments, but in that case the investment was extrabudgetary. It indeed seems necessary to broaden the scope of budgetary control, including all public investments, especially those by public enterprises. I note especially the coexistence of emerging budget deficits and the special funds, which continue to increase their net creditor position with the banking system.

The staff notes that the pricing mechanisms may have contributed to the weak performance of the economy, and that an increasing share of locally produced goods might have been channeled through the parallel market. Mr. Mawakani, on the other hand, stresses the flexible manner in which these mechanisms are applied. There seems to be a contradiction here: the more flexibly these mechanisms are applied, the more market forces are allowed to play their allocative role; but the idea behind the mechanisms is, I suppose, that market forces may lead to socially or politically undesirable outcomes. A flexible application of pricing and marketing mechanisms may thus leave both goals unattained. With this in mind, I urge the authorities to take bolder steps to liberalize the economy.

On the external side, I am concerned about the buildup of arrears. On page 10, the staff notes that debt service has increased rapidly due to the substantial disbursements of highly concessional aid. These must have been large disbursements indeed. This is especially worrisome because, as Mr. Mawakani notes, weaknesses in the management of the external debt contributed to the Government's inability to service it.

On monetary policy, I wish to stress the importance of a point made by the staff on the last page of the report--namely, that selective credit policies, based on obligatory credit ratios, may run counter to the objective of promoting sound economic growth. Selective credit policies may hinder sound economic growth not only because they may encourage banks to be less stringent in their assessment of project viability--in order to avoid penalties for not having observed the credit ratios--but also because the credit ratios themselves may not adequately reflect an optimal allocation of resources.

Mr. Finaish made the following statement:

I agree with Mr. Mawakani that the authorities should be given credit for their adjustment efforts over the past three years, which have contributed to the generally improved economic performance. Having said that, however, I believe that the authorities would also agree that the effectiveness of their ongoing efforts could be increased if they adopted a clearer and more comprehensive adjustment framework that tackles the remaining imbalances in a broader and more mutually reinforcing manner. Clearly, such an approach would require some improvement in the information base, which is presumably part of the preparatory work for the formulation of a Fund-supported adjustment program, which is referred to on page 5 of the staff report. In this regard, it would be useful if the staff could comment on the preliminary timetable which has already been prepared by the staff of the Fund and the World Bank for that purpose.

To comment on a few policy questions, I do not disagree with the staff that it is desirable to reassess the pricing arrangements. On the other hand, there are indications that the current pricing policies have a significant measure of flexibility, as indicated by Mr. Mawakani. In any event, any reassessment of pricing policies should take into account the degree of competition, or lack of it, in the Burkinabè economy, so that the elimination of price controls in particular industries would not lead to even less efficient pricing.

Burkina Faso has had a public investment plan only since 1984 and, therefore, it is understandable that there are certain problems with it. However, in light of the debt-servicing situation and the crucial importance of ensuring that investment spending is on productive and financially sound projects, I welcome the authorities' efforts to improve the investment plan. In particular, I note that the authorities are collaborating with the World Bank on the formulation of a three-year rolling investment plan.

While the authorities should continue following a restrained fiscal policy, it is of course important to be able to interpret the fiscal data meaningfully. The figures provided by the staff cover treasury operations only, and, therefore, the figures on the deficit are not necessarily consistent with the monetary data on the position of the Government vis-à-vis the banking system. It would be useful if the staff could comment on how it sees the recent fiscal developments in light of the increase in the Government's net creditor position.

The increase in reserves is of course a welcome development, but there has also been an increase in external arrears. Clearly, the accumulation of external arrears can be detrimental to a country like Burkina Faso, which will inevitably continue to rely on foreign flows for some time. Therefore, I welcome the authorities' recognition of the need to improve debt management in general, and I encourage the authorities to try to maintain constructive relations with their creditors and donors.

The staff representative from the African Department remarked that although information on the 1987 budgetary outcome was not yet available, the staff presumed that the substantial financing gap had been covered by a further increase in payments arrears. Indeed, part of the financing gap had already been foreseen in the authorities' budget proposal for 1987. Although the staff had only examined the narrow area of the treasury accounts, it was justifiable to assume that arrears had also been accumulated in public entities outside the Treasury. The staff hoped that there would be an opportunity to obtain an overall picture of the fiscal situation. During the 1987 Annual Meetings, at the authorities' request, a list of requisite preparatory measures had been drawn up, along with a preliminary timetable for their implementation. With a view to preparing eventually a policy framework paper, the World Bank staff had recently indicated that a mission would be in Burkina Faso in February or March 1988 to assess the current situation, and to ascertain whether the authorities continued to express interest in pursuing discussions on an adjustment program.

Mr. Mawakani pointed out that some progress had been made in the fiscal area over the previous two years, particularly because of the reductions in salaries and wages. That self-imposed discipline in Burkina Faso--one of the poorest countries in Africa--was especially significant. Even the Fund would not have recommended such severe measures, the result of which had been a budget surplus, on a commitment basis, in 1986.

In 1987, as several Directors had observed, the situation had been different and the information available on it was incomplete, Mr. Mawakani continued. Weak economic management, as evidenced by the accumulation of arrears, was compounded by the lack of statistics. The arrears were not the result of a decision by the Government but a reflection of its inability to accurately assess the amounts currently due to creditors; hence, achieving a reduction in the arrears would require action not only by the authorities, but also an increased willingness by creditors to engage in dialogue.

Some progress had been made on pricing policy, with the system becoming more flexible, Mr. Mawakani noted. For example, before 1986, producer prices for cereals had been administered inflexibly, but after the official marketing agency was severely pressured by the substantial excess of the official prices over those negotiated by private traders, the authorities lowered official prices of cereals.

The Government was determined to hold a dialogue with international institutions, including the Fund and the World Bank, Mr. Mawakani indicated. A mission from the Bank was expected soon. As the staff representative had pointed out, discussions had also been held with the authorities during the 1987 Annual Meetings.

Although he agreed that there was a regrettable paucity of statistics, Mr. Mawakani said some progress had been made in other areas. Although it was perhaps difficult to evaluate the situation because of the shortage of information, clearly, in social and political terms, there had been some progress. The authorities were determined to address the problems facing the economy; they were open to technical assistance from the Fund. Assistance from the international community was certainly welcome.

The staff representative from the African Department commented that the staff had in no way meant to detract from the efforts that had been made by the authorities--particularly on the fiscal front in 1985 and 1986--which were reflected in the staff report. But it was also important to plan ahead, even though the available statistical information on the fiscal situation needed to be improved. It would be important to attempt to formulate a comprehensive view of the fiscal situation from 1987 onward--one that was more comprehensive than that provided by the Treasury's accounts. Presently, it was difficult to say whether the accumulation of arrears was due to lack of statistics, or to a need to improve financial management on the part of the authorities. However, credit should be given to the authorities for the progress made in 1985 and 1986.

Mr. Mawakani said that he agreed that there was a need to improve statistics. The authorities were prepared to take the required action, but more time was needed because the situation was complicated by the current move to a more flexible price system.

The Chairman made the following summing up:

Executive Directors generally agreed with the staff's appraisal in the report for the 1987 Article IV consultation with Burkina Faso.

Directors welcomed the substantial expansion of output in the past three years as well as the authorities' efforts to correct the fiscal imbalances, which had been reflected in an improvement in the Treasury's balance. Directors expressed concern that, in spite of these efforts, the budgetary and external sector positions remained difficult, as evidenced by the continued accumulation of payments arrears.

Against this background and the projected deterioration in the external sector over the medium term, Directors urged the authorities to adopt and implement a comprehensive set of adjustment policies aimed at achieving a sustainable rate of economic growth consonant with a viable external sector position.

With regard to the budget, Directors urged the authorities to reduce the fiscal imbalances, to eliminate the payments arrears, and to foster an increased flow of external assistance.

Directors encouraged the authorities to formulate a public investment program, and to strengthen the development strategy in close collaboration with the World Bank. Directors also encouraged the authorities to formulate a medium-term reform program for the public enterprise sector and considered it essential that the authorities adopt more market-oriented pricing and related policies.

Directors noted that substantial improvements are required in the statistical data base. They encouraged the authorities to continue their efforts to improve the availability and timeliness of statistical information, with the assistance of the Fund and other institutions.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/6 (1/13/88) and EBM/88/7 (1/15/88).

4. HAITI - 1987 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1987 Article IV consultation with Haiti to not later than March 18, 1988. (EBD/88/10, 1/12/88)

Decision No. 8773-(88/7), adopted
January 14, 1988

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/10 (1/13/88), by Advisors to Executive Directors as set forth in EBAP/88/7 (1/12/88), and by an Assistant to Executive Director as set for in EBAP/88/6 (1/12/88) is approved.

6. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/88/8 (1/13/88) is approved.

APPROVED: September 13, 1988

C. BRACHET
Acting Secretary