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Minutes of Executive Board Meeting 85/87

10:00 a.m., June 3, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. Lundsager, Temporary
	G. Ercel, Temporary
	X. Blandin
M. Finaish	N. Haque, Temporary
	K. Murakami, Temporary
	B. Goos
	Z. b. Ismail, Temporary
R. K. Joyce	L. Leonard
	H. A. Arias
	E. Olsen, Temporary
E. I. M. Mtei	A. Abdallah
	B. Jensen
Y. A. Nimatallah	E. M. Ainley, Temporary
	J. E. Rodríguez, Temporary
	A. Steinberg, Temporary
	A. V. Romuáldez
G. Salehkhou	
	A. Vasudevan, Temporary
	T. A. Clark
	I. Angeloni, Temporary
	L. Tornetta, Temporary
Zhang Z.	

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

IBRD: H. Reichelt, R. Westebbe, Western Africa Regional Office. African Department: A. D. Ouattara, Director; L. M. Goreux, Deputy Director; M. W. Bell, E. L. Bornemann, R. O. Carstens, C. J. Hoban, B. P. Ledoux, H. R. Lorie. Central Banking Department: R. B. Johnston. Exchange and Trade Relations Department: J. T. Boorman, E. H. Brau, L. H. Duran-Downing. Fiscal Affairs Department: C. Schiller. IMF Institute: S. Yao, Participant. Legal Department: J. M. Ogoola, J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; F. Drees, M. A. El-Erian, S. H. Hitti, H. E. Jakubiak, B. A. Karamali, E. B. Maciejewski, M. Shadman, S. Thayanithy, G. Tomasson, S. von Post. Western Hemisphere Department: S. T. Beza, Associate Director; S. J. Stephens. Advisors to Executive Directors: D. Hammann, J. Hospedales, G. E. L. Nguyen, M. Z. M. Qureshi, E. M. Taha, K. Yao. Assistants to Executive Directors: Bo T., Chen J., A. K. Diaby, C. Flamant, G. D. Hodgson, R. Msadek, W. K. Parmena, D. J. Robinson.

1. <u>IVORY COAST - 1985 ARTICLE IV CONSULTATION AND REQUEST FOR STAND-BY ARRANGEMENT</u>

The Executive Directors considered the staff report for the 1985 Article IV consultation with Ivory Coast and a request for a stand-by arrangement for Ivory Coast in an amount equivalent to SDR 66.2 million (EBS/85/113, 5/2/85). They also had before them a report on recent economic developments in Ivory Coast (SM/85/146, 5/21/85).

The staff representative from the African Department made the following statement:

> Most recent indications received by the staff on economic, financial and monetary developments of Ivory Coast are encouraging. The authorities' earlier forecast for the 1984/85 cocoa crop of 430,000 tons appears to have been conservative, and it now seems likely that cocoa production may reach an alltime record of 480,000-500,000 tons. During the first quarter of the year, fiscal receipts were also higher than forecast. On the other hand, public investment expenditure was lower than expected.
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> In spite of a high level of crop credit, total net domestic assets were well below the program ceilings during the first few months of the year. This reflected mainly a rapid increase in bank deposits, as a consequence of the reduction in public sector payments arrears, which seems to have been in line with the program targets. Net claims on the public sector were also below ceiling during this period.
>
> A number of the measures included in the proposed 1985 financial program have recently been taken. The Caisstab had transferred CFAF 120 billion to the budget and the CAA by the end of April. On May 17, Ivory Coast, Ghana, and Togo signed the debt-sharing agreement for CIMAO, the multinational clinker plant located in Togo, as indicated in the letter of intent. The formula for the indexation of consumer prices of refined petroleum products, which will be applied retroactively to March 1, the date of the most recent increase, has been agreed on. The related decree is expected to be signed shortly. The audits of the five specialized banks and the studies aimed at improving the tax policy and enhancing tax collection have been started.
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> Finally, the Paris Club meeting on Ivory Coast is scheduled for June 25 and 26.

Mr. Alfidja made the following statement:

During 1981-83, the Ivorian authorities made strenuous efforts, with the support of the Fund and the World Bank, to restructure the Ivorian economy and stabilize the finances of the country. However, owing to the interplay of factors such as the appreciation of the U.S. dollar, the sharp rise in international interest rates, the severe drought in the region, and the worsening of the terms of trade, the performance of the economy was generally less satisfactory than expected. To improve the economic and financial situation, the Ivorian authorities launched another financial program in 1984 which was supported by the Fund. It focused on the reduction of both the budget and external current account deficits, the reduction of payments arrears, and the restructuring of the parastatal sector.

The outcome of the 1984 program shows a combination of favorable and unfavorable developments. On the one hand, the reduction of the budget deficit, including the operating losses of the largest state enterprises, was beyond program projections. Inflationary pressures abated moderately and the external current account deficit, as a percentage of GDP, was substantially lower than envisaged under the program. On the other hand, real GDP continued to decline and the reduction in payments arrears was not as large as planned owing to factors beyond the control of the authorities. However, the unsatisfactory performance in the real sector and the nonobservance of the target on payments arrears should not overshadow the strength of the measures taken and the significant progress achieved in 1984 toward restoring the financial viability in the economy. By way of example, in the fiscal sector, the freeze on wages was maintained and electricity and water tariffs were raised to reduce government transfers to state enterprises. Furthermore, the decision to close down two sugar manufacturing plants resulted in considerable savings. Other actions were also taken to stimulate output. In the agricultural sector, the producer prices of all major cash crops were raised substantially. Furthermore, a new investment code was adopted and put into effect in 1984 with a view to encouraging the development of small businesses and the use of locally produced intermediate goods.

In spite of the improvement in the internal and external imbalances in 1984, the Ivorian authorities are aware of the need for further adjustments to consolidate the progress made under the previous programs. To this end, they have adopted another financial program for which they are seeking Fund support. In addition they are requesting the World Bank's financial assistance in support of their structural adjustment efforts. Similarly, Ivory Coast has requested the rescheduling of its external debt service obligations from official and private creditors in 1985.

The main macroeconomic objectives of the 1985 program include a reduction in the overall fiscal deficit by 2.3 percentage points to the equivalent of 1.5 percent of GDP and a substantial decrease in outstanding arrears. The external current account deficit is forecast to represent about 3 percent of GDP. The successful implementation of this program will hinge to a large extent upon the resumption of economic growth which is forecast to be 5 percent on account of higher agricultural and manufacturing output. Agriculture, the driving force of the economy, will continue to be given priority. To further stimulate growth in this sector and improve farmers' real income, the producer prices of major cash crops will continue to be adjusted whenever warranted. Steps are also being taken to improve the management and efficiency of extension service agencies. Several export-promotion measures designed to encourage industrial production are being implemented and others are being explored.

The projected decrease in the budget deficit is to reflect a rise in revenue stemming from a substantial increase in contributions from the cash crop marketing board. Tax revenue is expected to increase by 5 percent, reflecting the impact of the tax measures introduced under the 1984 program and the effect of increased efforts to collect tax arrears. In that regard, a committee has been established to work on consolidation of domestic arrears and to monitor the payments of these tax arrears due to the state Treasury. On the expenditure front, civil service wages and salaries will be frozen for the third consecutive year and the strict limitation on new hiring will be maintained. Furthermore, with the implementation of the three-year "ivorisation" program, the number of official as well as private technical assistance personnel will be reduced significantly, resulting in savings estimated at CFAF 10 billion a year.

Concerning the state enterprises, steps are being taken to make them financially viable. Wages and salaries in this sector have been aligned with those in the civil service. In addition, the retail price of petroleum products has been increased and are to be indexed to the CFAF-valued cost of the refinery's inputs with a view to improving the financial situation of the oil refinery.

In the banking sector, steps have been taken to redress the difficult financial situation of several institutions. In this connection, four major banks were required to increase their provision for nonperforming loans. The Central Bank of West African States (BCEAO) has tightened its supervision of the daily operations of smaller banks, with emphasis being placed on improved collection of delinquent loans and more generally on better management. The authorities will consider additional measures after a study to assess the banks' portfolio by the World Bank is completed.

Finally, on external debt matters, my authorities are aware that the debt service ratio will remain high in the medium term and might adversely affect economic growth. To prevent a worsening of the country's debt profile, the Government has adopted a cautious attitude toward external borrowing on commercial terms. I therefore urge the Executive Board to adopt the proposed decision.

Mr. Mtei observed that owing to exogenous factors, Ivory Coast's GDP had been falling at an accelerating rate since 1982 despite the authorities' concerted adjustment effort supported by two structural adjustment loans from the World Bank and by an extended arrangement and a stand-by arrangement with the Fund. According to the staff's scenario, GDP would increase by 5 percent in 1985 and would continue growing in the medium term. That growth momentum would enable the authorities to eliminate the public sector and external current account deficits by 1990 as planned and the external and domestic arrears in a few years. The prediction of a revival of economic growth in Ivory Coast was based on the continuation of good weather, a favorable external market environment, and high levels of capital inflows. The staff had estimated that about CFAF 385 billion a year of official external capital would be required in 1986-90. The substantial financing gap that would remain in that period would be filled through a combination of debt rescheduling and net additional inflows. The requested stand-by arrangement would act as a catalyst in that endeavor and would pave the way for the Paris Club debt rescheduling agreement expected to be finalized in June 1985, which would release funds to finance the gap of CFAF 222 billion projected for 1985. That rescheduling should bring the projected medium-term debt service to a manageable level of 39 percent in 1985, declining to about 34 percent in 1990.

Ivory Coast's experience had demonstrated that adjustment must be accompanied by economic growth in order to be sustainable, Mr. Mtei stated. The failure of the extended arrangement in 1981-83 showed the vulnerability of a fragile open economy--which relied for 65 percent of its export earnings on three crops--to worsening terms of trade, unexpectedly high interest rates, and drought. Performance under the 1984 stand-by arrangement had been better than expected in some areas; for example, the external current account deficit had been reduced to 2.8 percent of GDP compared with the program target of 7.7 percent of GDP, owing primarily to higher than expected proceeds from cocoa and coffee. The staff's sensitivity analysis indicated that a 10 percent shortfall in coffee and cocoa prices would lead to a public sector deficit of 3 percent of GDP and an external current account deficit of 2 percent of GDP. Without some success in the medium-term development strategy, the program targets for the public sector deficit and the external current account deficit were unlikely to be achieved. The staff should, therefore, be more flexible when viewing Ivory Coast's performance under the proposed stand-by arrangement.

There was a greater need for diversification and structural adjustment than for stabilization, Mr. Mtei considered. The authorities were rightly emphasizing supply side policies within the framework of the World Bank structural adjustment program, which was aimed at growth and diversification in the primary and industrial sectors and at public enterprise rehabilitation. The third World Bank structural adjustment loan currently being negotiated should play a major role in placing the economy on a firm and sustainable growth path.

In addition to playing a catalytic role in obtaining the required capital inflows, the stand-by arrangement would provide the necessary discipline and timetable for adjustment in the public sector, Mr. Mtei considered. In the fiscal field, the 1984 program had laid the basis for central government budgetary control, generating a surplus equivalent to CFAF 61 billion. The authorities had been fairly successful in rehabilitating the public enterprises under the program. However, despite the reduction in the consolidated deficit of those enterprises, the overall public sector had still registered a deficit. The authorities' intention to continue their efforts to eliminate the public sector deficit was commendable.

Mr. Blandin stated that he supported the proposed decisions. For the first time in four years, the strenuous adjustment effort undertaken by the Ivorian authorities was beginning to bear fruit. The overall public sector deficit had declined abruptly from 9.8 percent of GDP in 1983 to 3.8 percent of GDP in 1984 and was projected to decline further to 1.5 percent of GDP in 1985. Similarly, and not surprisingly, since the reduction of the public sector deficit had been accompanied by a tight monetary policy, the current account deficit had been reduced by 10 percentage points of GDP between 1983 and 1984 and, in 1985, should remain at approximately the same level as the previous year.

Those commendable results did not imply that the adjustment effort had been less firmly pursued in 1981-83, Mr. Blandin remarked. Rather, they indicated that the poor results initially achieved had been due primarily to exogenous external developments, such as the deterioration in the terms of trade, increase in interest rates on external debt, and severe drought which had reduced agricultural production and exports. With the reversal of those adverse developments in 1984, the various economic indicators had improved immediately, although clearly the improvement in the economic indicators in relation to GDP had been due in part to the continuing decline in GDP since 1981. However, the improvement in those indicators in 1985 was all the more remarkable as economic growth had resumed.

Progress had been made only because the authorities had been able to build on the economic adjustment initiated in 1981, Mr. Blandin observed. Adjustment was a slow and painful process, but determined and consistent discipline ultimately paid off. An extended arrangement remained the most appropriate framework for a lengthy adjustment process, as it allowed for coordination between macroeconomic and structural, supply side adjustment measures. The amount of resources available under an extended arrangement should take into account the outstanding use of Fund resources by a member.

The recovery in agricultural production and exports, especially of cocoa, coffee, and cotton, had been particularly impressive and owed much to the increases in producer prices implemented under the previous program, Mr. Blandin considered. The positive price differential introduced in favor of coffee was welcome and in line with previous suggestions from his chair. At a minimum, producer prices should be maintained in real terms. Ideally, real prices ought to be increased on a regular basis. The resulting rise in real incomes of farmers, in addition to continuing the necessary reversal of the internal terms of trade, could help to enlarge the market for domestically produced industrial goods, thereby having a strong transmission effect. Such an approach would represent a return to the policies of the 1960s and early 1970s, known as the so called Ivorian miracle. The rural population had thus far paid a dear price for the ill-conceived investment projects in the industrial sector in terms of the high levies of the stabilization fund, which represented an important part of fiscal revenues.

It was encouraging to observe that the industrial sector had also played a role in the economic recovery of Ivory Coast, with manufacturing exports increasing by 10 percent in 1984, Mr. Blandin remarked. That favorable development was due to the industrial policy implemented within the framework of the successive structural adjustment loans from the World Bank and testified to the competitiveness of the Ivorian economy. The stringent wage policies pursued in the public sector had undoubtedly affected private sector wage developments, helping to reduce unit labor costs and improve competitiveness.

The authorities should be commended for their courage in pursuing fiscal policies that were unpopular, particularly the freeze on salaries and promotions for the third consecutive year and the limitations on new recruitment, Mr. Blandin considered. Those policies were clearly appropriate; personnel expenditure had declined from 37 percent to 33 percent of total current expenditures between 1982 and 1985. Consequently, public savings had increased five-fold from 1.2 percent of GDP in 1982 to 6.1 percent of GDP in 1985. The outcome could have been even better if taxes had not declined from 21.8 percent of GDP in 1981 to 16.8 percent of GDP in 1985, a trend that derived from the reduction in economic activity and imports. It was therefore encouraging to note that measures had been introduced in 1985 to improve tax administration and collection and to broaden the tax base, with a view to increasing the tax/GDP ratio to 20 percent by 1989.

The burden arising from the repayment of arrears was substantial, representing 14 percent of total expenditures and net lending in 1985, Mr. Blandin noted. The bulk of those arrears would, however, have been repaid by end-1985, allowing some room for maneuver in the years ahead. Interest payments, which would amount to 29 percent of total expenditures and net lending in 1985, also constituted a heavy burden on the budget. However, that burden would not be alleviated quickly unless there were a significant decline in interest rates or a depreciation of the dollar.

The debt service burden was still such that financing gaps and debt service ratios would remain high until 1988, Mr. Blandin remarked. Given the uncertainty surrounding world markets for primary commodities, there was no room for complacency or for relaxation of the stringent policies currently in place. It was encouraging to note that the authorities were fully aware of the need to consolidate the progress made under the previous programs.

The World Bank, in close cooperation with the Fund, had mobilized large amounts of money in support of structural adjustment in Ivory Coast, Mr. Blandin observed. It had played a central element in ensuring the success of the adjustment strategy, helping to strike a proper balance between demand restraint and supply-oriented measures.

Mr. Steinberg noted that Ivory Coast had adopted both an extended and a stand-by arrangement with the Fund in the past four years. While Ivory Coast was not a prolonged user of Fund credit, its outstanding balance in terms of quota was one of the highest, primarily on account of the recent extended arrangement. The economic performance and adjustment efforts in the past four years seemed appropriate given the difficult circumstances facing the authorities. The trade surplus had more than doubled to SDR 1.2 billion in 1984; the current account deficit had declined from more than 13 percent of GDP in 1981 to less than 3 percent of GDP in 1984; the public sector deficit had been reduced from 11 percent of GDP to about 4 percent of GDP in the same period; and the consumer price index had declined from 9 percent to 4 percent. GDP had declined at a cumulative rate of 12.5 percent betwen 1981 and 1984, a factor that explained, in part, the positive change in some economic indicators in relation to GDP, while manifesting a heavy loss to the economy. The authorities had introduced stringent budgetary controls and had cut the public investment program, resulting in a halving of investment in relation to GDP. Real wages had been virtually frozen and the incentive system had been reformed in favor of exports and rural development.

As the balance of payments had not yet reached a viable position and the external financial situation remained fragile, further adjustment efforts were required, Mr. Steinberg considered. The proposed stand-by arrangement would provide the authorities with the additional time necessary to deal with the economy's problems; it would also enable them to conclude the rescheduling arrangements with official creditors and commercial banks. He therefore supported the proposed decision.

The staff had not discussed in detail the exchange rate policy and the effects of the real effective depreciation of the CFA franc in the past four years on exports, imports, monetary aggregates, and domestic prices, Mr. Steinberg noted. Did the staff consider the pegging of the CFA franc to the French franc an appropriate exchange rate policy? What would be the effects of a weaker U.S. dollar as projected in the World Economic Outlook on Ivory Coast's economy?

Mr. Salehkhou observed that since 1980, the authorities had been pursuing vigorous Fund-supported adjustment programs. They had adopted prudent policies to isolate the economy from the effects of the adverse external environment, which was characterized by high interest rates, volatile exchange rates, the worldwide recession, drought, and falling commodity prices. Those adjustment programs had paved the way for long-term institutional and structural rehabilitation of the economy. Ivory Coast had had to maintain and enhance its creditworthiness in order to attract new concessional capital and make repurchases to the Fund. The 1984 adjustment program had been aimed specifically at improving the country's creditworthiness and the external sector by reducing economic imbalances, particularly in the public sector.

Under the 1984 program, the definition of the public sector and its financing had been enlarged to cover the operations of the major public enterprises, Mr. Salehkhou noted. Although revenues had been lower than targeted, mainly as a result of tax shortfalls, the consolidated public sector deficit had been in line with the program's objectives, as the revenue shortfall had been offset by lower expenditures and net lending. The finances of the large enterprises continued to exert a heavy financial burden on the government finances. The operating losses and the debt repayment commitments of the sugar complex and the oil refinery accounted for one half of government transfers to all public enterprises.

The authorities had continued to pursue a prudent monetary policy in 1984, Mr. Salehkhou considered. Total net domestic assets had declined as a proportion of money stock, signifying a drop in credit to the public sector, while credit to the private sector had increased slightly.

The external position had improved in 1984, Mr. Salehkhou remarked. The current account deficit had been reduced, and the overall balance of payments had registered a surplus owing to a bumper harvest, rise in world market prices for cocoa and coffee, slower than projected increase in imports, and flexible exchange rate policy. Moreover, as a result of debt relief and debt rescheduling, the debt service ratio had declined significantly to 20 percent in 1984, slightly more than half its 1983 level.

Real GDP had declined by about 5 percent in 1984, while domestic inflation had remained moderate, largely because of the availability of food stocks, Mr. Salehkhou stated. However, the implicit GDP deflator had increased sharply, signifying higher prices in the traded goods sector as a result of the effective depreciation of the CFA franc.

Most of the quantitative performance criteria under the 1984 program had been met, with the major exception of the criterion on payments arrears, Mr. Salehkhou remarked. That slippage had been due to the shortfall in net credit to the public sector owing partly to the delay in the Fund purchase associated with the end-September performance criteria and partly to the authorities' difficulty in monitoring payments arrears. There had also been a shortfall in foreign financing in the last quarter of 1984, largely as a result of exogenous factors. However, the authorities had improved the monitoring of arrears, and other statistical problems were also expected to be solved.

The 1985 adjustment program was realistic, addressing the immediate economic problems in the light of the medium-term prospects, Mr. Salehkhou went on. Fiscal imbalances would be reduced, the external deficit stabilized, and the productive sectors of the economy rehabilitated. While he was in broad agreement with the main elements of the program, he was uncertain about the appropriateness of the credit targets and their consistency with the projected real GDP growth target. According to Table 11 on page 26 of EBS/85/113, net domestic assets were expected to expand at 8.7 percent in 1985, based on a rate of real GDP growth of 4.9 percent and a GDP deflator of 3.9 percent. However, net domestic assets had declined in 1984, failing to reach the 9.1 percent target. Therefore, a somewhat higher increase in net domestic assets should be expected under the ¿985 program. Furthermore, the performance criterion on credit to the private sector was based on the assumption that the programmed reduction in the public sector domestic payments arrears would limit the financing needs of that sector. The relevant criteria should be revised in case of any slippages. How supportive were the monetary targets of the growth objectives of the economy? Finally, he agreed with the proposed decisions.

Mr. Joyce stated that he supported Ivory Coast's request for a stand-by arrangement. Encouraging progress had been made under the previous Fund-supported programs, although not all performance criteria had been met and, consequently, Ivory Coast had been unable to make full drawings under those arrangements. Persistent imbalances in some sectors required that the strong adjustment strategy be maintained. The authorities were to be congratulated for the greater than programmed reduction in the fiscal and external current account deficits in 1984. However, difficulties had been experienced in eliminating external payments arrears. Ivory Coast should aim to fulfill its external obligations as a matter of high priority under the new program. In addition, the fiscal and external current account deficits should be reduced further.

Ivory Coast could expect to face a tight financial position for some years to come, even with the maintenance of strong adjustment efforts, Mr. Joyce observed. Of particular concern was the prospects for international reserves, which had fallen sharply since 1979. The medium-term outlook was highly sensitive to external developments, which were traditionally volatile. Within such an environment, a high level of international reserves would be desirable, although there was little room to build up reserves in the near term. Nevertheless, the authorities should take any available opportunity to strengthen their reserve position.

A reduction in the public sector deficit was a prerequisite to strengthening the economy's financial position and reducing domestic arrears, Mr. Joyce commented. Efforts to improve the public sector balance through expenditure restraint were courageous. Public sector wages were to be frozen for a third consecutive year; the wage bill would actually decline in 1985. Stringent controls had been placed on capital expenditures, which, together with net lending, had already declined by about 40 percent since 1980. What would be the long-term effects of the current level of capital expenditure and the economic impact of further cuts? The World Bank's advice would be welcome in that area. On the revenue side, the authorities' efforts to implement a comprehensive tax reform to improve the tax/GDP ratio were welcome. Could the staff provide a progress report on that matter in the first review under the stand-by arrangement?

The financial position of public enterprises also needed to be strengthened, Mr. Joyce considered. The large losses of the parastatals, particularly the sugar complex and oil refinery, which together accounted for one half of government subsidies to the public sector, had been a particular burden on the budget in 1984. Despite the adjustment measures taken in 1984, the deficit of the public enterprises had continued to increase, reaching 5.8 percent of GDP. A reversal of that trend was essential if a viable fiscal position were to be achieved. He therefore welcomed the projected decline of about 11 percent in the overall deficit of the public enterprises in 1985 as a result of tariff increases. The authorities should continue their strategy of trimming costs in those enterprises. The World Bank was playing an important role, particularly with regard to the financial reforms of the oil refinery.

Improved coordination between monetary and fiscal policies was necessary, Mr. Joyce said. A more restrained credit policy in 1985 would help the authorities to achieve the program objectives. Furthermore, the financing agreement with external creditors and the reforms of the banking system would ease some of the constraints that had hindered the operations of the financial sector in 1984.

Adequate economic growth and the achievement of a viable external position in the long term depended heavily on a successful realignment of domestic production and a strengthening of the export sector, Mr. Joyce stated. The restructuring of the agricultural pricing system was a step in the right direction and, together with efforts to improve the input supply system and the provision of services, had promoted a shift of resources to the agriculture sector and provided production incentives. The ongoing reform of industrial policy, including the adjustments in the trading system, should also help to broaden the export base over time. However, the authorities had been implementing policies aimed at promoting export diversification for a number of years. Could the staff comment on the progress that had already been made and on additional measures that were expected?

Difficulties had been experienced in monitoring payments arrears under the 1984 stand-by arrangement, a factor that had delayed the purchases scheduled for end-December, which in turn had delayed the reduction of payments arrears, Mr. Joyce noted. There had been some improvement in the situation since then, but the authorities and the Fund should ensure that the difficulties did not recur. Ivory Coast was paying a heavy price for past mistakes, but the authorities had demonstrated their commitment to implementing necessary adjustment measures as quickly as possible. They deserved the Executive Board's full support.

Mr. Clark stated that he welcomed the progress made under the 1984 stand-by arrangement, especially the adjustments in domestic prices and the marked improvement in the fiscal and external positions. However, there had been some less satisfactory aspects of the overall economic outcome. Some of the progress had reflected special factors that were unlikely to be sustained, such as the sharp increase in cocoa exports at the end of 1984. The underlying momentum of adjustment would have to be maintained for a number of years to come.

The key to further progress would be tighter fiscal control, Mr. Clark considered. Major subventions to the parastatals had to some extent vitiated improvement in the central government finances, and, on the revenue side, there were continuing problems with the tax base, structure of taxation, and administration of the tax system. Although GDP was projected to increase by 5 percent in 1985, tax revenue as a proportion of GDP was expected to decline. A great deal of the expenditure restraint in recent years had relied on a freeze of public sector wages. Could the staff comment on how long it was likely to be possible or wise to continue that freeze and how far the focus might be switched to more rigorous restraint, or indeed contraction, of the number of civil service employees?

He was concerned that performance had slipped at the end of each of the previous two arrangements with the Fund, Mr. Clark stated. In both cases the final drawing had not been made. His chair had expressed concern in the past about such slippages at the end of or, especially, between programs. Footnote 1 of Table 12 in the staff report indicated that performance criteria for the proposed stand-by arrangement would be projected from the actual position at end-1984. In the present case, that practice presented no difficulty because most of the performance criteria appeared to have been met. But if later data should reveal that the peformance criteria had not, in fact, been met, the performance criteria under the new stand-by arrangement should not be adjusted to accommodate any deviation.

The staff had given a broad indication of how the financing gap under the present arrangement might be met through rescheduling arrangements with the Paris Club, the London Club, and the group of creditors referred to as the Abidjan Club, Mr. Clark commented. It would have been helpful if the staff had elaborated on the amounts and likely timing of the expected rescheduling arrangements. He was particularly concerned in view of the experience in 1984 when activation of the program had been seriously delayed by problems with financing and given some recent instances where financing that had seemed relatively assured had not materialized, causing the program to go off track. He would be interested to know why the staff had not proposed conditional approval of the stand-by arrangement requested by Ivory Coast. In conclusion, he welcomed the adjustment efforts of the authorities and strongly encouraged them to continue their efforts. He supported the proposed decision on the stand-by arrangement, subject to the question he had raised about conditional approval.

Ms. Lundsager observed that Ivory Coast's performance under the 1984 stand-by arrangement had been mixed. Export growth had been considerably higher than expected, leading to a substantial reduction in the external current account deficit, including grants, to 2.8 percent of GDP, compared with the target of 7.2 percent of GDP. However, economic growth had declined by nearly 5 percent in 1984. Fiscal adjustment had been on target, with a public sector deficit of 3.8 percent of GDP. The fiscal deficit had fallen dramatically since 1982, when it had equaled 13 percent of GDP on a commitment basis. In addition, the consolidation of the fiscal accounts to include the largest parastatals greatly facilitated analysis. The less than programmed reduction in arrears had been disappointing, given the need to improve relations with creditors and suppliers. Could the staff indicate whether the external arrears had been eliminated by April 1985, as expected?

The ambitious growth target of 5 percent in 1985 might not be attainable, even though producer prices had increased in 1984 and weather conditions had improved, Ms. Lundsager considered. In spite of the early cocoa harvest in late 1984 and the larger cocoa crop expected in 1985, a turnaround in the real economy was questionable. However, the achievement of the targeted rate of growth was essential if the fiscal deficit and domestic arrears were to be reduced as planned. The projected rate of increase of revenues appeared to be more realistic in 1985 than in 1984, but if economic growth fell short of target, revenue growth for the year might be less than expected. For the long-run revitalization of the economy, expenditure restraint rather than revenue expansion should be emphasized. Was the projected increase in the item "materials, supplies, and transfers" of almost 20 percent (Table 4, EBS/85/113) really warranted? Ivory Coast was making some progress on containing the wage bill through nominal wage and hiring restraint. However, it still represented more than 50 percent of current expenditures, and wages in Ivory Coast were high by international standards. Strong efforts were needed to reduce relative wage costs in the public sector, which would then influence private sector wage settlements.

Other positive steps were being taken to contain the fiscal deficit, Ms. Lundsager noted. Decreased enrollment in the civil service schools should have both an immediate impact on educational costs and a longer-term impact on the size of the civil service. The emphasis on reducing domestic arrears was important to restoring normal operations in the private sector. While the investment budget was not increasing by a large amount, with World Bank assistance it appeared to be better formulated and financed than in the past.

The parastatals remained an overwhelming problem in Ivory Coast, Ms. Lundsager commented. Their large operating deficit, which would only fall to 4.8 percent of GDP in 1985 from 5.8 percent of GDP in 1984, represented a heavy burden on the economy. Several difficult steps had been taken, including a realignment of wages that had resulted in some nominal wage decreases. Nevertheless, a faster pace of adjustment would have been preferable in that sector. The extensive World Bank involvement, particularly in the oil company and, more generally, through several structural adjustment loans, should provide support for that effort. It was reassuring to learn that the first review under the stand-by arrangement would include an examination of progress in the parastatal sector overall, as well as of specific developments in the three largest entities.

Credit would remain tight in 1984, helping to contain aggregate demand and, thus, demand for imports, Ms. Lundsager observed. With positive real rates of return on savings, the national savings rate should increase. Furthermore, the improvements in banking regulation and enforcement should help to restore confidence in the banking system.

The medium-term outlook for Ivory Coast was in many respects much better than in other African countries, Ms. Lundsager considered. Both the fiscal and current account deficits might be eliminated by the end of the decade if exports grew as rapidly as predicted. Nonetheless, a high debt service burden remained and would result in financing gaps in the medium term. Additional external resources would be needed, but with continued strong economic adjustment the international creditor and donor community was likely to be of assistance. The permanent elimination of external arrears was essential. In addition, foreign investment in Ivory Coast should be encouraged with continued macroeconomic adjustment, positive economic growth, and more competitive wages. The authorities should look to direct investment inflows to help close the projected financing gaps. What was the staff's view about the possibility of using exchange rate adjustments to bring wages to competitive levels and to promote export diversification?

Foreign direct investment was all the more important as Ivory Coast was a prolonged user of Fund resources, with total use of Fund credit amounting to more than 300 percent of quota, Ms. Lundsager remarked. Under the present stand-by arrangement, total outstanding use of Fund credit would fall owing to repayments under the compensatory financing facility. In the medium term, the authorities should not rely on the Fund as a continuing source of financing. She was particularly concerned about their intention to continue requesting Fund support in future years. As the requested debt rescheduling arrangements should be sufficient to close the 1985 financing gap and as policy adjustments would be made at the time of the first review if necessary, she could support the proposed decision.

Mr. Ainley stated that he supported the proposed decisions. The authorities had made commendable adjustment efforts within the framework of two Fund-supported adjustment programs. Encouraging progress had been made in reducing the imbalances in the fiscal and external accounts, and appropriate policies had been put in place to deal with longstanding structural weaknesses. There was no doubt of the authorities commitment to adjustment.

However, difficult problems persisted, particularly regarding arrears, Mr. Ainley observed. The medium-term outlook was very tight, given the heavy debt service burden. As the authorities recognized, further efforts were needed to achieve a viable external position and to build up international reserves. The adjustment program seemed realistic and well designed to meet its objectives. The emphasis on promoting growth, which had declined in recent years, and on revitalizing the private sector was particularly welcome. Steady growth was essential if countries like Ivory Coast were to repay their debts. The comprehensive measures being taken to stimulate agricultural production, develop energy resources, and improve competitiveness in manufacturing, with support from the World Bank, were encouraging. When were the negotiations for a third structural adjustment loan likely to be completed?

The momentum of fiscal adjustment should clearly be maintained, Mr. Ainley considered. The moves to restrain current expenditure, streamline the civil service, and concentrate investment spending on a number of quick-yielding projects were welcome. On the revenue side, the authorities had appropriately taken action to remedy the deficiencies in tax collection procedures, and studies to reduce tax exemptions and broaden the scope of tax were under way. Those steps should set the stage for a steady reduction in domestic arrears, a process that had already begun. The new monitoring arrangements should be useful in that regard.

The public enterprises continued to present a major fiscal problem, Mr. Ainley noted. Improvements were being made in that sector, particularly through the introduction of a new formula for petroleum pricing. Nevertheless, there was scope for further steps to reduce the operating costs and strengthen the management of those enterprises. The close involvement of the World Bank in that effort was welcome.

The proposed credit ceilings appeared consistent with the targeted improvement in the balance of payments, Mr. Ainley remarked. The continuing financial problems in the banking system remained a cause for concern, but the authorities were to be commended for their recent efforts to strengthen banking supervision. They had drawn up a detailed financial plan to eliminate external arrears, an important objective that would improve external confidence and strengthen Ivory Coast's creditworthiness, thereby attracting new money to finance adjustment.

Mr. Goos indicated that he was in full agreement with the staff appraisal and that he could support the proposed stand-by arrangement. The policies agreed under the arrangement appeared broadly appropriate.

Ivory Coast's economy apparently had improved considerably in 1984, with substantial and impressive reductions in domestic and external imbalances. It was particularly encouraging that further progress had also been made toward structural reform of the agricultural and industrial sectors. Those results were all the more commendable as domestic economic activity had continued to be depressed in 1984.

Nevertheless, like the staff, he felt that more progress in several areas would have been desirable, particularly in restoring the viability of public enterprises, which remained the most pressing fiscal problem, Mr. Goos pointed out. Also, the authorities' repeated failure to meet the 1984 program objectives regarding payments arrears was disappointing. The argument that those slippages had been largely attributable to delays in disbursements of financing would become unconvincing if repeated too often. The staff was apparently addressing the underlying causes of those delays when they recommended a strengthening of overall financial management of the economy, including better coordination of fiscal and monetary policies. Improvements in those areas would also go a long way toward correcting the financial situation of the public enterprises.

Despite the improvements in 1984, Ivory Coast continued to face substantial challenges in the external accounts, Mr. Goos considered. The country would have to meet enormous debt service obligations, including large repayments to the Fund, in the remainder of the decade. According to the staff's medium-term scenario, Ivory Coast would also need substantial external resources, which would have to be met largely through exceptional financing. Indeed, as the staff had put it, the medium-term outlook was difficult, and he strongly endorsed its view that the authorities should pursue comprehensive adjustment efforts to restore a viable external payments position. In particular, they should make further substantial progress in tackling the country's structural weaknesses by initiating broad-based diversification of the economy and addressing the financial problems of the public enterprises with determination. They should continue their close collaboration with the World Bank, which in many respects was better equipped than the Fund to assist Ivory Coast in the medium term. In any event, the country had already made considerable use of Fund credit in terms of its quota. The envisaged reduction in Fund exposure in Ivory Coast in the course of the new program was therefore appropriate.

Mr. Zhang stated that he supported the proposed decisions.

Mr. Vasudevan remarked that he could support the proposed decisions. He would be interested in hearing the staff response to Mr. Salehkhou's question on how realistic the credit targets might be in the context of the projected increase in real GDP. Although it could be argued that the extended arrangement had laid the basis for structural adjustment in Ivory Coast, exogenous factors, such as weather, had affected the outcome of the adjustment program. How durable would be the impact of World Bank schemes to improve agriculture, through irrigation and extension services? Agricultural development was the key to the success of adjustment programs in Ivory Coast.

Mr. Angelloni stated that subject to the staff response to Mr. Clark's question on conditional approval, he could support the proposed decisions.

The staff representative from the African Department remarked that Ivory Coast was a member of the West African Monetary Union. The exchange rate of the CFA franc was common among members of that union and was a fixed rate vis-à-vis the French franc. Ivory Coast's external reserves were held in the joint operations account of the monetary union with the French Treasury. Such an exchange system had provided flexibility and had enabled Ivory Coast to have a negative reserve position in the operations account for several years. That negative position had improved by CFAF 52 billion in 1984 and, according to preliminary figures, had improved by a further CFAF 14 billion in the first three months of 1985. The impact of the real effective depreciation of the CFA franc had been felt mainly on the export side, as many of Ivory Coast's exports were denominated in U.S. dollars. Local receipts in CFA francs had increased, explaining in part why the surplus of the stabilization fund had been increasing sharply. Imports had declined in the past few years owing largely to the economic recession, but also to the decline in real GDP and the depreciation of the exchange rate. The effective depreciation had also affected Ivory Coast's external debt, which was largely denominated in U.S. dollars. The debt burden had therefore increased sharply. Some of the gains on the export side had been used to finance the external debt service burden in local currency.

The credit targets under the 1985 program were consistent with the growth projections, the staff representative indicated. Credit expansion was estimated to be almost 9 percent, while the rate of inflation was expected to be about 5 percent. The staff projected that public sector arrears to the private sector would be reduced substantially, resulting in a transfer of liquidity from the Government to the private sector. The outcome of the first few months of 1985 had shown that there was no pressure on the credit targets thus far, largely because of the substantial decrease in public sector arrears.

Ivory Coast's exports were made up largely of cocoa and coffee, the staff representative commented. Export diversification had been limited, although the trend in the past year had been more encouraging. Sustained efforts in the context of structural adjustment policies being introduced with the help of the World Bank would be necessary to bring about a substantial change in export composition.

How long wage restraint could be continued was difficult to determine, the staff representative considered. There had been no increases in public sector wages for three years, and it was unlikely that the wage freeze could continue indefinitely. In the staff's view, the authorities should concentrate on reducing the number of civil service employees. Virtually all new government employees in the higher grades were recruited from the Government's professional training schools. The authorities had successfully reduced the number of students entering those schools by about 50 percent, but the impact of that reduction would not be felt for a few years. The authorities' determination to continue implementing wage restraint and limiting the number of wage earners was encouraging.

The total external financing gap for 1985 was estimated to be CFAF 222 billion, of which CFAF 104 billion was estimated to be met from the London Club rescheduling agreement, CFAF 97 billion from the Paris Club, and CFAF 21 billion from the Abidjan Club, the staff representative indicated. The agreement with the London Club had effectively been completed and was conditional only on the approval of the stand-by arrangement with the Fund and on agreement being reached with the Paris Club. The Abidjan Club was primarily a group of private suppliers that had supplied goods and services for the Government outside the banking system. The terms of rescheduling of debts due to the Abidjan Club were similar to those of the London Club. The staff fully expected the rescheduling agreement with the Paris Club to be completed, following a meeting of the Club scheduled for June 26.

The staff did not have firm figures on outstanding external arrears for end-April 1985, the staff representative from the African Department stated. However, it could be concluded from indirect sources that the external arrears of the public sector had declined substantially.

The staff representative from the Exchange and Trade Relations Department recalled that at EBM/84/155 (10/24/84) the Executive Board had agreed that approval of an arrangement in principle should be resorted to only sparingly and should be an exceptional procedure. The Executive Board had urged the staff to consult closely with creditors in advance to determine the likelihood that financing would be available to meet the financing gap under a proposed Fund arrangement. The London Club rescheduling agreement with Ivory Coast was virtually complete, being conditional only upon the approval of the Paris Club and Abidjan Club rescheduling agreements. The staff had learned from the Secretariat of the Paris Club that there were no outstanding problems regarding the bilateral arrangements under the previous rescheduling arrangement, which had also included a goodwill clause. The staff therefore recommended outright approval of the stand-by arrangement requested by the Ivorian authorities.

The staff representative from the African Department, responding to questions from Mr. Clark, stated that when the staff had discussed the adjustment program with the authorities, it had not had available the final figures for various indicators for end-1984. The staff had based the performance criteria under the 1985 program on the estimated positions for end-December 1984, which had been finalized since then.

One of the considerations of the commercial banks that were involved in the rescheduling arrangements of the London Club was that "facilities would be granted by the World Bank," the staff representative noted. The staff understood that consideration to mean that the banks wished to see continued World Bank involvement in Ivory Coast, perhaps in the form of a further structural adjustment loan.

The staff representative from the World Bank remarked that the Bank expected to reach agreement with the Ivorian authorities on a third structural adjustment loan in the next few months. Emphasis would be placed on structural adjustment in the agricultural and industrial sectors. Efforts to ensure economic growth should concentrate on diversification in the agricultural sector, particularly in crops such as palm oil, rubber, pineapples, coconuts, and, to a lesser extent, cotton. Ivory Coast would continue to rely heavily on coffee and cocoa production. The differential in pricing in favor of coffee had improved the output of that crop. The authorities were being urged to provide incentives for production through appropriate pricing policies. The extension system for both food and export crops would be supported by projects to provide the necessary infrastructure, including feeder roads, markets, storage facilities, and research programs. In sum, efforts would be strengthened to allow Ivory Coast to develop its full potential in nontraditional export crops.

Mr. Alfidja stated that the wage issue was sensitive in Ivory Coast as in many other countries. Real wages should not be allowed to fall below a minimum level, in order to avoid problems of low morale and social unrest. The Executive Board should not have high expectations regarding the reduction in the wage bill, a task that had to be faced with World Bank assistance. Other international organizations such as the International Labor Organization and the United Nations Development Program might also provide assistance. The public sector wage bill would decline only after the economy had been restructured and the private sector was in a position to absorb the majority of the labor force.

The Acting Chairman made the following summing up:

Executive Directors generally concurred with the thrust of the staff appraisal in the report for the 1985 Article IV consultation with Ivory Coast. Directors expressed satisfaction that, during 1984, substantial progress had been made in the reduction of internal and external imbalances and the restructuring of the economy. In particular, Directors commended the authorities for the reduction in the public sector's total expenditure, especially the continued restraint on personnel outlays, and welcomed the actions taken to rehabilitate loss-making public enterprises.

The Government's producer pricing policies and strict fiscal and monetary policies, along with favorable weather conditions and an improvement in the terms of trade, enabled the country to reduce the external current account deficit by as much as 10 percent of GDP to less than 3 percent, well in excess of the amount targeted in the revised 1984 program. The substantial real effective depreciation of the CFA franc in recent years was also noted. While Directors regretted that the objective set for the reduction in arrears had not been met, they nevertheless recognized that the shortfall was explained in large part by the delays in the disbursement of the new money from commercial banks. Directors welcomed the commitment by Ivory Coast to eliminate rapidly the remaining external arrears and to reduce further domestic arrears.

Directors expressed concern about the difficult medium-term prospects of Ivory Coast, which largely reflected the constraints imposed by the heavy debt service obligations. Directors emphasized Ivory Coast's continued dependence in the medium term on substantial capital inflows and rescheduling of external debt as well as the need to build up international reserves. They urged the authorities to maintain the momentum of their adjustment efforts, and stressed the importance of further reducing external and internal deficits while stimulating agricultural production, improving the competitiveness and promoting the diversification of the industrial sector, and reducing the burden of public sector enterprises on public finances.

In this respect, Directors agreed that the policies described in the financial program for 1985 constituted an appropriate response to the problems that Ivory Coast was facing, and they welcomed the much improved economic outlook for this year. More specifically, Directors emphasized the importance of appropriate producer prices, including the possibility of increases in real prices. They also emphasized the importance of measures envisaged by the authorities both to broaden the tax base and to improve tax administration.

Several Directors noted the courageous decision of the authorities to freeze civil service salaries for the third year in a row, and to maintain the strict limitation on new hiring. Looking to the future, some Directors encouraged the authorities to continue to limit the wage bill mainly by constraining new hiring. The need to maintain an appropriately tight monetary policy and to strengthen banking supervision was also referred to by Directors.

Finally, Directors welcomed the role and financial support of the World Bank, in particular in the context of the structural adjustment programs, assistance in public enterprise rehabilitation efforts, and improvements in the quality of the public investment program.

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

The Executive Board then took the following decisions:

Decision Concluding 1985 Article XIV Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Ivory Coast, in light of the 1985 Article IV consultation with Ivory Coast conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Ivory Coast continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 7993-(85/87), adopted
June 3, 1985

Stand-by Arrangement

1. The Government of Ivory Coast has requested a stand-by arrangement for a period of 12 months from June 3, 1985, through June 2, 1986, in an amount equivalent to SDR 66.2 million.

2. The Fund approves the stand-by arrangement set forth in EBS/85/113, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7994-(85/87), adopted
June 3, 1985

2. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya (SM/85/132, 5/13/85). They also had before them a report on recent economic developments in the Socialist People's Libyan Arab Jamahiriya (SM/85/142, 5/20/85).

Mr. Finaish made the following statement:

Economic policymaking in the Jamahiriya in recent years, as in several other oil exporting countries, has been dominated by the adjustments required by the large drop in oil export receipts. Faced with a decline in international demand for oil resulting from both recessionary conditions and conservation policies, and an increase in oil exports by some non-OPEC producers, the country had to lower successively its oil production levels as part of OPEC agreements to stabilize the oil market. The current production ceiling of 0.99 mbd compares with an average production of about 2 mbd in the second half of the 1970s and the historic high of about 3.5 mbd 1970. The decline in production, coupled with falling oil prices, caused oil revenues to drop by more than one-half between 1980 and 1984. The task faced by the authorities in adjusting the economy's absorption levels to the reduced flow of revenues was, thus, a considerable one. Since the drop in revenues starting in 1981 was quite sharp, large deficits emerged in the fiscal and external accounts as expenditure levels could not be adjusted at the same pace because of commitments already made. Since then, however, expenditure and credit policies have been considerably tightened, and the authorities have been successful in substantially reducing the fiscal and external deficits. However, with the revenue decline continuing, the deficits remain sizable, calling for continued restraint in financial policies.

The development strategy followed in the country has centered around the utilization of revenues derived from exporting oil--a nonrenewable asset--and in developing new types of productive activities so as to lay the basis for sustained, broad-based growth. Development policies are carried out within the framework of five-year plans. The large increase in oil revenues in the 1970s permitted a rapid growth of investment in infrastructure and industrial capacity, at the same time as improvements were made in basic social facilities to raise the level of welfare of the people within a socialist framework. During the 1976-80 Plan period, non-oil GDP grew at an average of about 11 percent. The growth rate fell to an average of less than 4 percent in the first four years of the 1981-85 Plan as a result of cutback in expenditures following the drop in oil revenues, which was reflected in actual investment expenditures falling short of Plan allocations by about 40 percent during the period. However, growth in agriculture and manufacturing--the key sectors under the strategy of economic diversification--still averaged 7 percent and 12 percent respectively.

Within the manufacturing sector, special emphasis has been given to export-oriented oil-refining and petrochemical industries, and the products of these industries are now a significant export item. The authorities are concerned at the danger posed to a fuller exploitation of the country's potential comparative advantage in this line of production by the growing protectionist pressure in industrial countries with respect to petrochemical imports. Alongside the hydrocarbon-based industries, some other industries have also been established that produce a variety of consumer and intermediate goods for the domestic market. To further agricultural development, a major irrigation project was launched in 1984 that would bring water by a pipeline network from desert aquifers to coastal farm lands.

The 1986-90 Plan currently under preparation retains the emphasis on reducing the economy's dependence on oil through the expansion of the agricultural and industrial productive base. The Plan's targets are being drawn up in line with the reduced availability of financial resources; the targeted non-oil GDP growth rate of about 4 percent compares with that of over 10 percent under the 1981-85 Plan. Priority would be given to the completion of ongoing projects and effective utilization of the installed capacity. While most industrial units are state-owned, the establishment of private ventures on a partnership basis is being encouraged. Greater attention is being given to promoting light industries. In order to accelerate the development of domestic manpower resources and reduce the dependence on foreign labor, educational and training facilities are being expanded. Furthermore, the transfer of Libyan workers from service sectors, including public administrative services, to commodity producing sectors is being encouraged.

As a result of measures taken to restrain public expenditures, the large overall fiscal deficit that emerged in 1981 was roughly halved in 1982 and, according to estimates that are still preliminary, was reduced further in 1983-84 despite the continuing drop in oil revenues. Between 1982-84, total public expenditures were reduced by about one-third. The curtailment of expenditures was achieved through a variety of measures, including tighter expenditure control procedures, lower allocations for certain administrative expenses, a freeze on certain types of hiring and the withholding of salary increases, reduction in subsidies through price adjustments, and cutbacks in lower priority development expenditures. The budget for 1985 projects a further reduction of about 15 percent in total public spending. On the revenue side, emphasis has been placed on raising the contribution of non-oil revenues. A substantial increase in these revenues is projected for 1985, which is to result partly from expanded coverage and improved collection of customs and excise duties and partly from higher transfers from public enterprises. The latter is to result from an expected increase in the profitability of several enterprises that have been transferred to public companies to be run as independent entities as well as the enhancement of the Treasury's supervisory responsibilities over public bodies in general. The transfer of some public enterprises to the corporate sector would also contribute to lowering administrative expenditures included in the budget. On the basis of these expenditure and revenue projections, and assuming that oil revenues remain broadly stable, the authorities believe that the overall fiscal deficit in 1985 could fall to less than half the 1984 level.

The tightening of the fiscal stance since 1981 and the contractionary impact of the external deficit have both contributed to a sharp reduction in liquidity growth. Domestic liquidity fell in both 1983 and 1984. It is estimated to have increased by 4.5-5 percent in 1984, reflecting mainly the Treasury's recourse to the banking system, and a roughly similar outcome could be expected in 1985. Measures have been taken to tighten bank lending to public enterprises. As a result, outstanding credit to these enterprises remained virtually unchanged during 1982-84. Measured by the consumer price index, inflation over the past few years has averaged about 8 percent.

Developments in the balance of payments broadly mirror fiscal developments, as they mainly reflect changes in oil exports and the impact on imports and other external payments of changes in public spending. Thus, the overall external deficit was sharply reduced in 1982 as a result of substantial cuts in expenditures, and consequently in imports. Although oil export receipts continued to decline in 1983-84, and investment income also fell, the overall deficit was further reduced as these developments were offset by the continued curtailment of expenditures and imports. While the staff projections show only a marginal reduction in the overall deficit in 1985, the authorities believe that the reduction could be greater, though the deficit would remain significant. It is noteworthy that, despite the financial difficulties, the country's foreign aid program has been continued.

The authorities have refrained from resorting to external borrowing, focusing instead on domestic adjustment and allowing the deficits to be reflected in a drawdown of reserves, which as a result have fallen substantially. They intend to strengthen their efforts to restore external balance under the 1986-90 Plan and are aiming at eliminating the overall deficit early in the Plan period. To that end, demand management policies would be strengthened, further progress would be sought in effecting economies in import requirements and advancing import substitution, and the dependence on foreign labor would continue to be reduced. The authorities are of the view that the mission's observations about the medium-term balance of payments outlook do not adequately take into account these factors. Regarding a change in the exchange rate policy, the question has been under consideration. The authorities wish to point out that several factors need to be taken into account in considering this question, including the impact on expenditures in domestic currency terms, the centrally planned nature of the country's economic system, and the existing structure of domestic production and exports which implies that the possible beneficial effects of an exchange rate adjustment on exports and imports could be expected to materialize mainly over the medium to long term.

In the context of its centrally planned economy, import planning and exchange control regulations have been a feature of the country's economic system for the past many years. The authorities had allowed a gradual relaxation to take place within this regulatory framework during the period of growing foreign exchange receipts. With the tightening of the external financial position, it was expected that the existing regulations would be applied somewhat more strictly. However, the decline in import payments and in outward remittances does not necessarily imply an intensification of restrictions in these areas. These payments items have been decreasing in a number of other countries that have market-oriented economies and this has resulted essentially from substantial reductions in activity. The only restriction subject to Fund approval that has been imposed is the reduction of travel allowances, which is a relatively minor restriction and has been imposed temporarily. The need for maintaining this restriction has been reviewed periodically and the intention remains to remove it as soon as possible.

The authorities are conscious of the need to strengthen the economic and financial data base. The compilation and presentation of balance of payments and monetary statistics has been improved in recent years. Technical assitance received from the Fund in this area has been useful, and the authorities have requested further assistance to improve price data. Attention is being given to improving the timeliness and accuracy of fiscal data. With respect to the reported discrepancy between monetary and fiscal accounts for 1983-84, the authorities have pointed out that it is largely explained by two factors: the actual fiscal deficit appears to have been less than that indicated by the mission's estimates; and the increase in unclassified assets of the banking system in 1983 mainly consisted of Central Bank credit to the Treasury temporarily recorded in the Bank's suspense account. On the basis of their examination of the rather large changes occurring in the past few years in the unclassified items in the monetary accounts, the authorities consider the matter to be temporary and indicate that it would be resolved.

Mr. Nimatallah commended the authorities for adopting appropriate policies in response to the sharp decline in oil receipts. In addition to reducing public spending sharply, they had conducted a cautious credit policy, chosen not to borrow abroad, and prudently avoided a sharp reduction in imports to avoid disrupting domestic activity and rekindling inflation. However, those policies had not been without cost; adjustment to a lower level of oil receipts had resulted in the depletion of foreign reserves.

Given the uncertainties in the oil market and the decrease in financial reserves, intensified adjustment efforts would be necessary to achieve sustainable growth, Mr. Nimatallah observed. The forthcoming Five-Year Plan reflected a vigorous attempt to reduce the financial imbalances, but spending cuts should not fall disproportionately on capital spending. Instead, the authorities should undertake a more comprehensive adjustment program embracing the whole public sector and should avoid intensifying restrictions that suppress imbalances without removing their underlying causes.

The Five-Year Plan would help to diversify the productive base of the economy and generate sustainable real growth in the non-oil sector, Mr. Nimatallah stated. Diversification efforts could be enhanced by faster development of the agricultural and industrial sectors; agricultural development, for example, would benefit greatly from the completion of the major irrigation project. Export-oriented oil refining and petrochemical industries were also being developed. However, the authorities were rightly concerned that the country's comparative advantage in those areas was being undermined by protectionist policies in industrial countries. All industrial countries should help the Jamahiriya and other oil exporting countries--essentially those having a comparative advantage in refining and petrochemicals--to develop their full potential. Could the staff elaborate on how exchange rate action might enhance exports? The authorities had made commendable progress thus far, but they should improve the accuracy of economic and financial data.

Mr. Salehkhou observed that since the previous Article IV consultation with the Jamahiriya, the economy had deteriorated, reflecting the downturn in the international oil market. Both production and unit prices had dropped significantly, causing a sharp reduction in receipts from oil exports. While the Jamahiriya's situation was typical of other oil exporting countries, the severe cutbacks in administration and development expenditures had almost equaled the increase in development expenditures during the boom year, when oil prices and production had been at a high point. The economy was heavily dependent on the oil sector; up to 1980, the gross foreign reserves of the Jamahiriya had amounted to $14.2 billion and the current account surplus had been equivalent to 23 percent of GDP. The authorities' response to the downturn in the oil market had been immediate and had been fully reflected in the 1980-85 Five-Year Development Plan, which aimed to reduce the dependence on the oil sector, expand the economy's absorptive capacity, and develop manpower resources. The authorities had concentrated on both adjusting the economy to sharply reduced incomes and achieving financial balance. The continuous decline in oil production in 1983 and 1984 had forced the authorities to take further measures to move toward financial stability, including the elimination of certain subsidies, reduced allocations of foreign exchange for travel, and higher internal levies on cigarettes and gasoline.

The development effort undertaken by the authorities to integrate the oil sector through local refining was impressive, Mr. Salehkhou considered. After completion of the Ras Lanuf refinery, refining capacity had increased to 358 thousand barrels a day, with the country well on its way to exporting 150 thousand barrels a day of refined products. The increase in petrochemical exports had been due particularly to the Jamahiriya's competitive advantage because of its proximity to the European market. However, the EC's imposition of a 14 percent import duty on petrochemicals in 1984 might well create problems in 1985 and beyond.

In the non-oil sector, the Jamahiriya had made tremendous strides, particularly in the agricultural sector, which had expanded sharply in recent years, Mr. Salehkhou noted. However, during 1984 agricultural production had declined by 3.7 percent owing to drought. The authorities had strongly emphasized self-reliance in food production. Agricultural extension schemes were being implemented, producer price guarantees introduced, and large irrigation schemes established to bring water from the desert to the coastal farmlands, thus boosting agricultural production.

In the manufacturing sector, Mr. Salehkhou went on, capacity underutilization had hampered growth. While the focus had been on light industries, a number of technical problems remained. Construction activities had also slowed, reflecting decreasing public spending on infrastructure. Nevertheless, the non-oil sector had grown by 2.9 percent in 1984, compared with 0.9 percent in 1983.

Despite the reduction in imports and in remittance outflows, the external current account had remained in deficit in 1984 owing largely to the decline in export earnings, which had decreased by 10 percent since 1983, Mr. Salehkhou observed. As a consequence of the further deterioration in the capital account, gross foreign reserves of the Central Bank had been drawn down to $3.5 billion at end-1984 from the record $14.2 billion in 1980. However, official external debt remained insignificant as the authorities continued to refrain from foreign borrowing. They aimed to eliminate the budget and balance of payments deficits in 1985 by continuing to pursue tight monetary and fiscal policies.

The authorities did not consider it necessary to depreciate the currency from its traditional peg to the dollar in view of the dominant role of oil in the economy, limited demand elasticity for non-oil exports, and internal price stability, Mr. Salehkhou remarked. They believed that the economic situation could be improved, and the budget and external position, stabilized through the continued pursuit of adjustment efforts, rescaling and postponing of major projects, and improving capacity utilization and productivity.

While credit had been restricted for the past four years, banks were expected to resume activities in 1985, Mr. Salehkhou noted. A 6 percent expansion in the non-oil sector was expected in 1985 owing to gains in capacity utilization and productivity. The outlook for the years ahead was being charted within the framework of the 1986-90 Development Plan, which emphasized the need to develop the non-oil sector and boost food production through the River Project, the backbone of the irrigation system. Overall growth was expected to be 4 percent, reflecting the sharp reduction in government outlays and the long gestation period of support projects. One by-product of reduced government spending had been the gradual but steady replacement of foreign workers by local trainees and administrative personnel who were being transferred to production units.

The consultation discussions with the authorities had centered on the adjustment efforts necessary to redress the internal and external imbalances in the wake of changing oil prices and declining production, Mr. Salehkhou observed. The authorities had been keen to introduce new measures to stem the outflow of reserves and restore financial equilibrium, but the lack of certain data on oil revenues called for further assistance from the Fund.

Ms. Lundsager remarked that since the 1982 Article IV consultation with the Jamahiriya, the authorities had adjusted their economic policy stance in response to the continuing slack in the world oil market. Unfortunately, data collection efforts and consistency checks between policy indicators had remained somewhat weak, providing an unclear picture of economic performance and the effects of economic policy. The authorities should enhance the statistical base to improve the formulation of economic policies and to better achieve their long-term economic goals.

The fiscal deficit had remained high in the past two years, as cuts in expenditures, while substantial, had been less than the decrease in oil revenues, Ms. Lundsager observed. It was not surprising that expenditure cuts had lagged; the large cushion of external reserves built up in the 1970s had permitted flexibility. An even tighter rein on expenditures would be needed to prevent the fiscal deficit from depleting foreign exchange reserves completely. Table 1 of SM/85/132 indicated that gross official reserves could fall by one half in 1985, to the equivalent of only about 3 months of imports. The authorities aimed to reduce total spending by 15 percent in 1985. Several policy adjustments, including subsidy reductions and limitations on civil service wages and employment, would have the added benefits of improving resource use. Also noteworthy was the spinning off of public enterprises to be operated as independent entities, with the expectation that they would be profitable and thus provide additional support to the government budget.

The authorities might consider two additional resource-generating measures, Ms. Lundsager continued. First, interest rates should be increased to create incentives to save. Given the longer-term development goals and the authorities' prudent desire to avoid extensive foreign borrowing, stronger domestic incentives were necessary. Second, an exchange rate adjustment might encourage a broader range of economic activity in the Jamahiriya. While an adjustment would obviously have little impact on oil exports, it might generate interest in producing import substitutes domestically, nontraditional exports, and products that might otherwise have been uneconomical to produce.

Mr. Zhang observed that following a sharp decrease in oil receipts in 1981, the authorities had been forced to adopt an adjustment program that had been generally successful. With the continuing weak world oil market and the decline in oil receipts by almost one half between 1980 and 1984, the magnitude and intensity of adjustment had been large during the past three years. The authorities had reduced public spending significantly and restrained credit expansion to the public enterprise sector. In sharp contrast to the experience of many other countries undertaking adjustment programs, growth in the non-oil sector had continued to increase in 1983 and 1984, after declining in 1982 because of poor agricultural production.

The external current account deficit had been reduced in 1984 to one fifth of the 1981 level, owing largely to the decrease in imports, Mr. Zhang commented. The Jamahiriya's positive results had to a great extent been attributable to the existence of a planned economy. The implementation of the adjustment program had been facilitated in many ways by more cohesive and coordinated policies under central planning. For instance, the authorities had been able quickly and effectively to reduce imports by means of direct restrictions and to forgo foreign borrowing, thus avoiding the external debt problem currently besetting other countries. But apparently the staff had a more negative view of central planning.

The authorities would most likely maintain their policy stance in the future, barring a sharp favorable upturn in the world oil market, Mr. Zhang noted. The 1986-90 Development Plan would continue to aim at reducing the country's dependence on oil by expanding the agricultural and industrial productive base.

The staff considered that the existing policy of direct control on imports would not solve the longer-run problem but would merely suppress the imbalances without removing the underlying causes, Mr. Zhang remarked. By contrast, the staff thought that a devaluation was the most appropriate and natural solution as it could contribute to the development objectives, particularly to import substitution and, in general, to more efficient resource allocation. Although a devaluation could have positive results, the staff's position was somewhat surprising, as it seemed to contradict the Fund's usual emphasis on an exchange rate policy aimed at export promotion rather than import substitution. While exchange rate policy could be used to promote import substitution, experience had shown that a straight devaluation was often ineffective for that purpose. Could the staff elaborate on the short-term effects of a devaluation on the country's economy, particularly on its current adjustment program? The immediate and specific contribution of a devaluation to the adjustment effort was questionable, given the low price elasticities of demand for imports, the large and direct impact of increased prices for essential imports on the Jamahiriya's domestic price levels, and the authorities' wish to reduce total imports selectively. The measures currently being pursued conformed more closely to the centrally planned nature of the economy and catered more directly to immediate adjustment needs. The authorities' intention to approach devaluation more cautiously at the present stage of economic adjustment, while keeping exchange rate policy under constant review, was appropriate.

Mr. Alfidja remarked that the economic and financial performance of the Jamahiriya in 1983/84 had continued to be adversely affected by the depressed international oil market. Oil production and revenues had decreased substantially, contributing to a downward trend in economic activity and straining public finances in the external sector. The economy had responded positively to the measures taken by the authorities in 1982 to adjust the economy to changes in the oil market. The fiscal deficit had been almost halved to 15 percent of GDP in 1982 and had been reduced further in 1983. If fiscal and monetary data were reconciled, the higher deficit in 1984 might turn out to be lower than indicated. The external sector had also improved, with the 1984 current account deficit being one fourth of the level recorded in 1981.

Commendable progress had been achieved toward diversifying the economy, Mr. Alfidja observed. The share of the non-oil sector in total output had increased steadily from 36 percent in 1981 to 55 percent in 1984, with economic activity in that sector growing continuously except for in 1982. However, the non-oil sector had not expanded as expected, despite the amount of resources that sector had absorbed. Agricultural performance had been affected by unfavorable weather, and manufacturing performance by capacity underutilization. Measures had been taken to develop the agricultural sector; especially noteworthy were the supply of credit to farmers, extension services, irrigation facilities, and the producer pricing policy designed to provide incentives to farmers. However, the authorities should take measures to reverse migration from the countryside to the cities in order to reduce the economy's dependence on foreign labor. Their emphasis on improving existing capacity utilization in the manufacturing sector was appropriate.

The balance of payments deficit had been financed through a drawdown of gross official reserves, which had been rapidly depleted in 1983/84, Mr. Alfidja noted. Given the prospects for the oil market, the authorities would be well advised to consider alternative ways of financing prospective deficits. Their intention to restore external balance early in the 1986-90 Plan period was welcome. External payments arrears would be settled by strengthening demand management, enhancing import substitution, and further reducing reliance on foreign labor. Finally, as the authorities had stressed the temporary nature of the exchange restrictions subject to Fund approval, he could support the proposed decision.

Mr. Tornetta remarked that the Jamahiriya had made commendable progress in adapting to continuously declining oil revenues. The weakness in the world oil market had seriously affected the fiscal balance and the balance of payments. The authorities had reduced expenditures, realistically scaling down investment and development projects; in 1981-85, actual investment outlays had been only 60 percent of those originally planned. The reduction of public investment projects, which had a large import component, had helped to improve the balance of payments position. Public development projects to expand the manufacturing and agricultural sectors were important to the economy's long-run growth. He therefore encouraged the authorities to contain the fiscal deficit by cutting administrative expenses and welcomed the projected decrease in nominal expenses in the 1985 budget. Training and education should continue to be emphasized so as to increase human capital resources in the economy.

The relatively large overall balance of payments deficits of the past few years had been financed through a reduction in official reserves, Mr. Tornetta observed. Further reserve reduction was not a viable solution for future years, as the stock of reserves had decreased from $14.2 billion at end-1982 to an estimated $3.6 billion at end-1984. Owing to the uncertainties in the oil market, the level of reserves should not be reduced much further. Instead, the authorities might consider moderate recourse to borrowing to finance development projects, along with a progressive tightening of demand and, in particular, of fiscal policies.

An exchange rate depreciation might have an adverse impact on the current account while giving rise to some inflationary pressures, Mr. Tornetta remarked. Import and export price elasticities were low, and there was limited scope for import substitution owing to the structure of the economy. Furthermore, the bulk of export receipts came from crude oil. Therefore, a depreciation would most likely benefit the economy only after the domestic manufacturing sector had been developed more fully. There was still a need to improve the collection of timely and accurate statistical data to permit the authorities to monitor the economy more effectively. The inclusion of data on national accounts, government finance, and monetary accounts in the International Financial Statistics and the Government Financial Statistics yearbooks was welcome.

Mr. Rodríguez observed that although the authorities had pursued adjustment policies that were in line with new economic developments, further measures would be needed to restore financial balance. He commended the authorities for pursuing policies aimed at restraining fiscal expenditure and resisting credit expansion. In response to the uncertain prospects for the oil market, the authorities had wisely reviewed development policies and reorganized their priorities. They had mobilized resources in the public sector, followed a prudent wage policy since 1982, and appropriately reduced development expenditures in order to restore the balance between revenues and expenditures.

The lack of current data on the Jamahiriya's economic situation was of some concern, although the country was developing its statistical resources and undergoing basic structural changes, Mr. Rodríguez commented. It would be essential for the authorities to have available reliable data in order to determine whether corrective measures would be needed. The drawdown of reserves to finance development expenditures from the equivalent of 16 months of imports in 1979 to less than 2 months of imports in 1984 was a matter of concern. Did the authorities intend to make use of multilateral foreign borrowing to finance the River Project? Finally, he commended the authorities for their commitment to continue providing foreign assistance despite the severe financial and economic difficulties facing the economy.

Mr. Jaafar stated that the authorities should be commended for responding quickly to the drop in oil revenues. They had diligently pursued a diversification program to expand the non-oil sector, which had represented more than 55 percent of GDP in 1984. Production incentives pursued by the authorities had been appropriate.

Timely measures had been taken to tighten fiscal policy and reduce credit expansion, Mr. Jaafar observed. The authorities' task of formulating budgetary and monetary policy would be facilitated by improving the financial data base. Any additional requests for technical assistance from the Fund to improve data collection and compilation should be supported.

To what extent had the relative stability of prices been due to the system of price controls and subsidies, Mr. Jaafar inquired. To what extent was the price control system a burden on public expenditure?

The deterioration in the external accounts had reflected developments in the oil market, which were unlikely to improve, Mr. Jaafar noted. Imports were required for the expansion of the manufacturing sector, and despite possible reductions in outflows of foreign workers' remittances and in foreign investment, the overall balance of payments was likely to remain in deficit. The authorities had reacted to the deterioration in the external accounts by restraining fiscal expenditures and import payments, while drawing down foreign exchange reserves to the equivalent of two months of imports from the substantial levels that had been accumulated in earlier years. Did the authorities realize the limit to the drawdown of those reserves? Would they consider borrowing or pursuing a more flexible exchange rate policy in response to the low level of reserves?

Mr. Abdallah observed that the Jamahiriya's economic and financial performance in 1982-85 had been shaped by developments in the oil market and reflected the country's heavy dependence on oil. A 50 percent reduction in oil proceeds in the past four years had led to a cumulative decline in real GDP of 25 percent and in total revenues of 56 percent. Despite the authorities' efforts to reduce expenditure and restrain credit expansion, external and domestic imbalances persisted.

Recent developments highlighted the need to diversify the economy by promoting the non-oil sector, Mr. Abdallah noted. The authorities were aware of the need to diversify and had adopted policies to encourage expansion of the agricultural and manufacturing sectors. Completion of the River Project and more efficient capacity utilization in the manufacturing sector should help to expand production in the non-oil sector. The 1986-90 Development Plan aimed to reduce dependence on the oil sector by concentrating expenditure on the completion of current projects and the effective utilization of existing production units.

The authorities were to be commended for their efforts to adjust the level of government expenditure to the decline in oil-related revenues, Mr. Abdallah continued. Total expenditure had been cut by about 33 percent in 1982-84 and a further reduction of 15 percent was projected for 1985. The Government had prudently decided to refrain from foreign borrowing. Most expenditure cuts had focused on the development budget, which had declined by about 25 percent in 1983/84. However, the authorities had allocated LD 1.7 billion for development in 1985, a much higher figure than the LD 1.2 billion that had been allocated for the administrative budget. Indeed, the persistence of large fiscal imbalances, as reflected by a budget deficit of 19 percent of GDP in 1984, required that further efforts be made to curtail expenditure and expand revenues. Despite recent measures to increase revenues, particularly through improved tax collection, a sizable expansion in non-oil revenues was needed to help reduce the budget deficit. Could the staff comment on the possibility of increasing revenues in the non-oil sectors?

The Government had increasingly resorted to bank financing, while credit to the private sector had remained stagnant, Mr. Abdallah observed. He urged the authorities to restrain fiscal expenditure in order to channel a larger proportion of bank credit to the private sector, thus enhancing its ability to contribute to the growth of the non-oil sector and to economic diversification.

The Jamahiriya's balance of payments position had been severely influenced by lower oil exports and falling investment income, Mr. Abdallah noted. The current account had recorded a deficit of 12 percent of GDP in 1981, as opposed to a surplus of 23 percent of GDP in 1980. However, continued curtailment of imports and workers' remittances had helped to reduce the current account deficit, while official reserves, which had been equivalent to more than 16 months of imports in 1980, had provided a useful cushion in the past four years. Those options were no longer available, as reserves had fallen considerably and a further reduction of imports could seriously hamper prospects for growth. In view of the limited possibilities for a substantial recovery in the oil market, the authorities should consider other short-term policy options to improve the country's external position. Continued pegging of the Libyan dinar to the U.S. dollar had led to an appreciation of the dinar, but the authorities' cautious approach to the issue was understandable in view of the arguments put forward by Mr. Finaish in his opening statement. He commended the authorities for continuing to provide development assistance despite their difficulties, but urged them to develop a more complete data base in an effort to improve economic analysis and policy making.

The staff representative from the Middle Eastern Department stated that the authorities were trying to mobilize domestic resources to finance the River Project, but they had not ruled out the possibility of foreign borrowing.

Although the effect of subsidies and price controls on the movement of domestic prices was unclear, available data indicated that prices had been increasing at an annual rate of 7-8 percent in the recent period, the staff representative commented. Price controls applied to a number of major commodities, but there had been some flexibility in pricing. The subsidy program, which had been recorded in the budget, was small and had been declining.

The authorities placed greater emphasis on eliminating the external deficit than on seeking sources of external financing, the staff representative observed. Should the deficit be considerably less than the estimated LD 0.5 billion in 1984/85, it could be financed from reserves. However, if developments were substantially different from expectations, the authorities would consider the need to resort to external financing.

The authorities had not planned specific measures to enhance non-oil revenues, the staff representative continued. Instead, they had aimed to increase the efficiency of the collection system, both by improving the collection of taxes levied and collected by the Treasury and by transferring certain government enterprises into independent entities capable of contributing to the public sector's savings.

The authorities had pursued adjustment through cutbacks in public expenditure and not through the use of exchange rate policy, the staff representative indicated. In fact, rough estimates indicated that as the Libyan dinar had been tied to the appreciating U.S. dollar, its effective exchange rate had appreciated such that instead of supporting the expenditure-reducing policy of the authorities, exchange rate policy had stimulated private sector demand for foreign goods and services, leading the authorities to tighten the existing comprehensive exchange controls. Import allocations had been reduced, causing some shortages of spare parts and raw materials for the operation of domestic industry.

In order to restore internal and external balance, appropriate demand management and fiscal policies would need to be pursued, with a responsive exchange rate policy playing a supplementary role, the staff representative from the Middle Eastern Department noted. In the short run, an exchange rate adjustment would be more likely to operate on the import than on the export side in the Jamahiriya. Given the country's comparative advantage in certain hydrocarbon-based exports, a depreciation would enhance the Jamahiriya's position vis-à-vis other potential exporters of the same commodities. A more responsive exchange rate policy would encourage import substitution and enable existing industries to operate at higher capacity. In the context of the centrally planned economy, the authorities would have to decide on correct producer prices so that the exchange rate policy could determine domestic price levels.

The staff representative from the Exchange and Trade Relations Department pointed out that in many cases export promotion was determined by a country's need to finance imports such as energy and services. In contrast, the Jamahiriya produced its own energy and had a negligible foreign debt, giving it more flexibility regarding its focus on export promotion or import substitution. An appropriate exchange rate would direct investment into the River Project and other agricultural projects. Similarly, from the point of view of energy production, an overvalued exchange rate could give the wrong signals to consumers of domestic energy, obviously affecting export potential in the long run.

Mr. Finaish remarked that economic and financial developments in the Jamahiriya had followed closely changes in the country's oil revenues. Spending had increased and economic growth accelerated following the increase in oil prices in 1973-74. As oil revenues stabilized in the second half of the 1970s, a period of consolidation had set in and economic growth had slowed. Following the oil price increases of 1979-80, economic activity had again increased rapidly. The large drop in oil revenues after 1981 had caused spending to be adjusted downward substantially and economic growth to fall. The Jamahiriya had been a very poor country prior to the discovery of oil. Economic policies during the period of increasing oil revenues had focused on building infrastructure and diversifying the economy. With the decline in oil revenues in recent years, the Government had decided to refrain from foreign borrowing and had focused on cutting expenditure. They intended to strengthen the implementation of necessary adjustments in the context of the 1986-90 Five-Year Development Plan.

The authorities were aware of the deficiencies in data collection and recognized the need for timely and accurate statistics for use in formulation and assessment of policy, Mr. Finaish commented. The compilation and presentation of balance of payments statistics had been improved with technical assitance from the Fund. The authorities had requested further assistance from the Bureau of Statistics in the area of price indices. Attention was also being given to improving the timeliness and accuracy of fiscal data. However, it would take time to improve the entire data base.

The Jamahiriya's exchange and trade system should be examined in the context of the centrally planned nature of the economy, Mr. Finaish remarked. The system of import planning and exchange controls had been in place for some time, and it was expected that with the reduced availability of foreign exchange, the existing regulations would be applied more strictly. It could not be assumed that because imports and outward remittances had declined recently that there had been an intensification of exchange restrictions. The same phenomenon could be observed in many other countries with market-oriented economies. Imports and remittances had fallen with the decline in economic activity. The only additional restriction subject to Fund approval that had been introduced was a reduction of travel allowances, which was a relatively minor restriction and had been introduced temporarily.

The authorities had an open mind on the use of the exchange rate to strengthen the performance of the external sector, Mr. Finaish commented. Exchange rate policy was currently under review. The impact on both imports and exports of an exchange rate adjustment would be limited in the immediate future, and any beneficial effects on the production of import substitutes and exportables would materialize only in the medium to long term. In view of the characteristics of the economy, the question of exchange rate adjustment acquired greater relevance in the context of the medium- to long-term strategy of economic diversification and structural change than in the context of short-term adjustment.

The decline in oil revenues had necessitated a cut in development expenditure, Mr. Finaish pointed out. The authorities had postponed some projects and were placing greater emphasis on improving the capacity utilization of existing projects. The new development plan would emphasize, within available resources, the development of the agricultural and industrial sectors. The authorities intended to finance the River Project through domestic resources, but they did not exclude the possibility of foreign borrowing.

The Acting Chairman made the following summing up:

Directors commended the authorities on the substantial progress achieved in adjusting the economy to sharply declining levels of income from oil. Expenditure restraints had been extensive, as the required adjustment was large and had been compounded by a sustained fall in oil receipts. Directors noted that the authorities had maintained a policy of refraining from external borrowing that would have been necessary to sustain a higher level of expenditure. It was observed that the tightened expenditure, complemented by a restrained credit policy, had contributed to a substantial reduction in the external sector deficit. Nevertheless, international reserves had declined rapidly while economic activity had slowed considerably, and the authorities had tightened restrictions on external transactions.

As the overall fiscal deficit in 1984 remained large and considerable fiscal and external deficits were likely to persist in 1985, Directors emphasized the need for further adjustment measures. The authorities' intention to eliminate the deficits after 1985 was welcomed. The growth targets in the next Plan were modest, indicating a continued policy of restraint. Some Directors expressed the hope that this stance would be supplemented by the use of the other economic instruments that were available to the authorities.

Noting the substantial appreciation in the Libyan dinar's exchange rate that had taken place in recent years, Directors expressed differing views regarding the appropriateness of an early correction or action in that area, but they observed that the increasing external constraints on the Socialist People's Libyan Arab Jamahiriya would eventually have to be addressed in a comprehensive manner. Directors encouraged the authorities to continue their efforts to diversify the economy and assess closely the need for appropriate exchange rate adjustment in support of such diversification.

With reference to the rapid development of the petrochemical sector in the Socialist People's Libyan Arab Jamahiriya, some Directors noted with regret the protectionist tendencies in some importing industrial countries. Directors noted that the intensified foreign exchange restrictions maintained by the Socialist People's Libyan Arab Jamahiriya for certain invisible payments had not been liberalized and that import allocations had been reduced. They expressed the hope that the authorities would be able to resume the liberalization stance they had followed for several years up to mid-1981.

Concerning the Socialist People's Libyan Arab Jamahiriya's external financial policies, some Directors remarked that there was little scope for further reserve reductions. Some Directors wondered whether resort to external borrowing to finance development projects could reduce the need for additional severe external adjustments and support growth and diversification.

Several Directors regretted that the quantitative analysis in the report was limited by the lack of adequate statistics on key factors of the economy. The authorities were thus encouraged to give priority to improving economic and financial statistics to provide a reliable basis for policy formulation. Directors also encouraged the authorities to consider technical assistance from the Fund in this area.

It is expected that the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya will be held on the basis of a 24-month cycle.

The Executive Board then took the following decision:

Decision Concluding 1985 Article XIV Consultation

1. The Fund takes this decision relating to the exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Section 2, and in concluding the 1985 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya, in the light of the 1985 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/85/132, the authorities reduced the foreign exchange allowance for certain travel abroad with effect from April 7, 1982. The intensified restriction is subject to approval under Article VIII, Section 2(a). The Fund notes the intention of the authorities to liberalize this restriction as soon as possible and, in the circumstances of the member, grants approval for the retention of this restriction until June 30, 1986, or the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is the earlier.

Decision No. 7995-(85/87), adopted
June 3, 1985

APPROVED: March 25, 1986

LEO VAN HOUTVEN
Secretary