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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/127

3:00 p.m., August 31, 1987

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	
	Jiang H.
	M. K. Bush
	M. Lundsager, Temporary
	J. Prader
	R. Morales, Temporary
	M. Arif, Temporary
	K.-H. Kleine, Temporary
	D. V. Nhien, Temporary
	L. M. Piantini, Temporary
	R. Comotto, Temporary
	L. P. Ebrill, Temporary
	C. V. Santos
	I. A. Al-Assaf
	C. Noriega, Temporary
	I. Puro, Temporary
H. Ploix	
	G. P. J. Hogeweg
	C.-Y. Lim
	S. Rouai, Temporary
	V. K. Malhotra, Temporary
	N. Adachi, Temporary
	F. Di Mauro, Temporary

L. Van Houtven, Secretary and Counsellor
M. Primorac, Assistant

Also Present

IBRD: B. Bruns, R. Skillings, Africa Regional Office. African Department: G. E. Gondwe, Deputy Director; R. R. Andely, R. O. Carstens, K. G. Dublin, C. Enweze, Y. Fassassi, U. R. Gunjal, J. K. M. Kinyua, S. N'guiamba, S. L. Rothman, G. H. R. Tersman. Exchange and Trade Relations Department: A. P. De La Torre, H. B. Junz. IMF Institute: T. Ramtoolah. Legal Department: H. Elizalde. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: S. M. Hassan, J.-C. Obame, J. E. Zeas. Assistants to Executive Directors: A. R. Al-Abdullatif, F. E. R. Alfiler, O. S.-M. Bethel, T. Morita, V. Rousset, D. A. Woodward.

1. THE GAMBIA - 1987 ARTICLE IV CONSULTATION AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1987 Article IV consultation with The Gambia and review under the 13-month stand-by arrangement approved on September 17, 1986 (EBS/87/170, 7/31/87, and Cor. 1). They also had before them a background paper on recent economic developments in The Gambia (SM/87/210, 8/17/87).

The staff representative from the African Department said that information had been received from The Gambia suggesting that the performance criteria and indicative target for end-June had been met; the staff would verify that information during its forthcoming mission to The Gambia. Apparently, the rate of growth in money plus quasi-money had been even higher than indicated in the staff report (EBS/87/170), which itself showed a higher rate of growth than projected in the initial program owing to a large increase in net foreign assets. The latest information suggested a rate of growth of money supply several percentage points above that forecast in the staff report, as a result of a further substantial increase in net foreign assets. The staff considered the willingness of nationals to hold balances in dalasis, rather than in foreign currency, to be an important contributing factor to the increase in money balances and part of the process of financial deepening. There had been no domestic contribution to monetary growth in 1986/87. In fact, domestic credit had declined by about 40 percent, or 60 percent of the base period money supply.

Bilateral agreements on rescheduling The Gambia's debts under the Paris Club had been concluded with Austria and Germany, as had been anticipated, at the end of July, the staff representative indicated. The Gambian authorities had been in London in the past week with hopes of concluding an agreement with the London Club.

Mr. Abdallah made the following statement:

> My Gambian authorities have asked me to extend their appreciation and gratitude to the Executive Board, management and staff for their support of the country's economic recovery program as manifested by the 13-month stand-by arrangement, the structural adjustment facility and the compensatory financing facility that the Fund has concluded with The Gambia. The authorities are in general agreement with the thrust of the staff analysis and appraisal of the Gambian economy. However, they do not agree with the staff's view expressed in the first sentence of Section II on page 2 of the staff report, which states that deterioration of the country's internal and external imbalances from the mid-1970s onward was the result of inappropriate domestic policies. While domestic policies may have contributed to the problem, it is important not to overlook the international dimension that aggravated the situation, namely, the deteriorating terms of trade, the decline in the price of the country's major export crop--

groundnuts--and the rise in the price of oil during that period. Furthermore, the drought that engulfed the Sahelian countries for some of this period depressed agricultural output. I would, therefore, request that the sentence be qualified.

The second review of the stand-by arrangement has reconfirmed the commitment of the authorities to the adjustment process, and their perseverance in confronting deep-seated structural imbalances with a view to achieving sustained economic growth under financial stability. A combination of a smoothly functioning interbank exchange rate system, cautious fiscal and monetary policies and flexible interest rate and pricing policies, together with significant external financial assistance, have enabled The Gambia not only to comply with the stand-by arrangement's performance criteria for end-March 1987, but also to achieve the major program objectives. In their latest communication, the authorities indicated that they have also met all performance criteria for end-June 1987 and that the economy has performed significantly better than projected under the program.

Growth in real GDP in 1986/87 is now estimated at 6 percent, compared with the initial program target of 3.5 percent. While groundnut production, which increased by about 40 percent, remains the major source of growth, expansion of output was broadly based, with construction, tourism, and commercial activities making substantial contributions. Inflation dropped to 20 percent from 70 percent the previous year. Moreover, gross foreign reserves accumulation and reductions of external arrears substantially exceeded the program's objective.

Fiscal performance for 1986/87 was in line with the program projections. The budget deficit as a percentage of GDP, on a partial commitment basis and excluding grants, is estimated to be lower than the program's target, mainly owing to a higher than projected increase in revenue and some expenditure savings resulting from a reduction in government employment. Using the higher than projected external grants and net foreign financing, the authorities not only reduced net bank financing of the budget but also reversed the Government's position to one of net creditor with the banking system. The budget performance for 1986/87 would have been even better were it not for the large transfer (equivalent to 8 percent of GDP) to the Groundnut Production and Marketing Board (GPMB) which became necessary partly because producer prices for groundnuts were 25 percent above world market prices.

Although the increase in money supply for 1986/87 is estimated to be slightly higher than the revised program target of 27 percent, it is worth noting that this was accompanied by a sharp increase in net foreign assets, a steep decline in net domestic assets and, in particular, net bank credit to the Government, indicating that the higher than envisaged growth in money supply was more a reflection of a financial deepening of the economy than of accommodating financial policies. Domestic credit in 1986/87 is estimated to have dropped by 39 percent--compared with the initial program target of 15 percent. This is mainly due to a sharp reduction in net bank credit to the Government while credit to public enterprises and the private sector remains within the ceiling under the program. The authorities' flexible interest rate policy combined with a decline in domestic inflation now provides a positive encouragement to savings. On the demand side a cautious lending policy is being implemented through reduced bank ceilings and an increase in commercial banks' reserves from 10 percent to 24 percent.

In the external sector, despite continued deterioration in The Gambia's terms of trade for the fourth consecutive year and the slightly higher than projected current account deficit in 1986/87, the overall balance of payments is estimated to show a significant surplus compared with the predicted deficit of SDR 10 million. Reduction in external payments arrears together with an increase in gross reserves are estimated at SDR 35.5 million, more than six times the initial program objective of SDR 5.5 million. These estimated favorable outcomes arise from higher than projected official flows, the smooth functioning of the floating interbank exchange rate system and prudent financial and interest rate policies which enhanced the private sector's confidence. The Gambia also concluded a debt rescheduling agreement with its Paris Club creditors. Nevertheless, the mounting debt service ratio, which is estimated at 55 percent after debt rescheduling in 1986/87, continues to overshadow the authorities' adjustment effort. It is to be emphasized that debt relief on more concessional terms and increased aid flows are necessary for achieving sustained growth and financial stability.

Prospects for 1987/88 indicate continued economic growth with subsiding inflationary pressures, while the overall balance of payments position is expected to record a somewhat larger surplus. The authorities note the staff's concern that continuation of the favorable performance would require the structural budget deficit and the problem of the large budgetary transfers to the GPMB to be appropriately addressed. They are aware of these problems and would like to emphasize that bold steps are being taken to reduce expenditure and increase revenue with a view to markedly reducing the structural budget deficit. Producer prices for groundnuts in the next season have been adjusted downward in line with the world market price, and a performance contract between the Government and the GPMB seeking cost reductions in the GPMB operations is being considered. The Government has also decided to use its net creditor position with the banking system to pay off the outstanding debts of the GPMB to the Central Bank to reduce the cost of interest payments which has been overburdening that organization. These measures are expected to reduce the need for budgetary subsidies substantially.

As regards the budgetary deficit, the authorities wish to reaffirm their commitment to reducing the deficit/GDP ratio by about 7 percentage points over fiscal years 1987/88 and 1988/89 to 9 percent, and to enhance the Government's creditor position with the banking system. Revenues are projected to increase by 12.5 percent in 1987/88 through improved tax collection. Consideration is also being given to a reform of the income tax law to increase yield by broadening the tax base and adjusting tax brackets and rates. To improve the tax structure and reduce dependence on the taxation of foreign trade, the Government is also studying the possible introduction of a general sales tax while reducing import duties on some products. However, it does not see much scope for increasing tax rates or introducing new taxes at the present time.

On the expenditure side, despite substantial erosion of public sector real wages and salaries, the Government has decided not to introduce a general salary increase in the 1987/88 budget, in an effort to contain expenditure. Together with reduced budgetary transfers, it is hoped that this will contribute to the reduction of the fiscal deficit. The budgeted increase in "other charges" is prompted by the need to reverse the deterioration in The Gambia's infrastructure over recent years. However, growth in development expenditures is being scaled down to 13 percent which will result in only a modest increase in the level of public investment. This amount is well below what was agreed with the World Bank in the public investment program, and the authorities intend to discuss this with the Bank staff.

The authorities would like to reassure the Executive Board of their strong commitment to the adjustment process and their determination to put their economy on a path of sustained growth and financial stability. They intend to continue their close cooperation with the Fund and the Bank. Finally, they are grateful for the external financial assistance they have received, which has been pivotal to the progress they have achieved so far; such aid is crucial for ensuring the success of their adjustment efforts in the coming years.

Mr. Comotto made the following statement:

It is my pleasure to open this discussion of The Gambia's 1987 Article IV consultation and second stand-by review, not least because of the substantial progress achieved since the last review. While progress was achieved on all fronts, I should highlight the improvement in reserves and the acceleration in the clearance of arrears. The Gambia's efforts continue to provide a compelling illustration of the complementarity of adjustment and development and what can be achieved by a combination of financial and technical assistance when the authorities, the Fund, the World Bank, and major donors work together.

On the external account, unanticipated aid receipts were an important contribution to the better than expected outturn in 1986/87. But it is significant and gratifying to see the growing role of private capital inflows and its reflection in a shift of deposits from foreign exchange to dalasis. The flow of both external assistance and private capital into The Gambia reflects growing confidence in the country's economy.

The whole edifice of confidence rests on the committed implementation of necessary policy measures--especially the achievement of the targeted reduction in the fiscal deficit by 1988/89. In this, the performance of The Gambian authorities has been impressive to date, particularly in the pursuit of realistic and effective exchange rate and interest rate policies. It is to be hoped that the future will see a continuation of this admirable record. Certainly, it is encouraging that advantage is being taken of the progress made so far in intensifying the policy reform's focus on the budget subsidy to the Gambia Produce Marketing Board (GPMB) and the structural budget deficit. The recent reduction in groundnut producer prices and the decision to use any gain from an increase in world market prices to further trim the subsidy to the GPMB are particularly helpful. We agree with the staff that the authorities' idea of using part of the sharp improvement in the GPMB's creditor position with the banking system to retire its debt would be appropriate. However, it will be essential to ensure that efforts to restore the GPMB to financial viability are pursued; the planned performance contract is crucial here.

More general fiscal reforms are also a desirable objective and the possible general sales tax and income tax reforms, in the context of further improvements in tax administration, should be expedited. Naturally, due account has to be taken of the limitations of The Gambia's administrative resources and further expert help will be needed. I would be interested to learn, at some stage, about the authorities' progress in collecting public sector tax arrears.

On other policy issues, I have equally little difficulty in endorsing the staff appraisal and the proposed decisions. I would urge the authorities to maintain the rigor of their adjustment effort in the hiatus in the program following the end of the present financial year. Notwithstanding the progress achieved so far, the current account remains rather vulnerable to adverse exogenous developments, and external debt remains high; it is vital not to lose the current momentum of progress. We await with interest staff proposals for future Fund support of The Gambia. A second stand-by arrangement, in precautionary form, might be helpful to preserve the appropriate orientation of policy and as a signal to reinforce the confidence of the international donor community. However, The Gambia's record would not be inconsistent with a comprehensive, carefully designed second-year program under the structural adjustment facility.

Finally, on a technical and subsidiary note, I would urge the authorities and the staff, in conjunction with the World Bank, to give due consideration to addressing various statistical issues, such as the important re-export sector. A more complete statistical measure of the economy will be of increasing importance in operating a well-directed and responsive policy. I would also request that the update of the policy framework paper outline the progress in reforming the banking sector and the credit system, and, in particular, offer the regional perspective which is so important to a small country like The Gambia.

Mr. Al-Assaf stated that he supported the proposed decision. It seemed clear that the authorities were beginning to have significant success with their adjustment program. The measures they had adopted and, in particular, the increasingly realistic manner in which their exchange rate policy had been managed, were commendable. The appropriateness of that policy was clearly demonstrated by the fact that The Gambia was currently experiencing private capital inflows. However, as the authorities well appreciated, The Gambia still faced significant economic imbalances. Those imbalances would be eliminated only if adjustment were sustained over the medium term.

On monetary policy, the dynamic nature of recent developments made the interpretation of monetary data very difficult, Mr. Al-Assaf said. While the rapid growth in some of the monetary aggregates was most likely a reflection of financial deepening, the authorities should, nevertheless, monitor the situation carefully. Carrying through on their intention to float a special bond issue to mop up excess liquidity would be very helpful.

The fiscal deficit remained large and clearly required further effort, Mr. Al-Assaf indicated. In that connection, high priority should be afforded to restraining government expenditures. The expenditure level was already high, at more than 40 percent of GDP, and the scope for increasing revenues seemed limited, notwithstanding the commendable plan to implement a general sales tax.

The authorities should persist with their efforts to reduce the subsidy on groundnuts, Mr. Al-Assaf urged. Their decision to assign the bulk of any improvement in world groundnut prices to a reduction of that subsidy was therefore welcome.

The more rapid than anticipated reduction in external arrears was commendable, Mr. Al-Assaf said. By showing their determination in that area, the authorities would increase their capacity to obtain concessional financial flows.

The authorities' achievements were praiseworthy indeed, but given the magnitude of the economic and financial problems facing the country, adjustment efforts should be sustained, Mr. Al-Assaf concluded.

Mr. Lim said that only three years ago, the situation in The Gambia had been deteriorating rapidly, with negative growth, rising inflation, and accumulating external payments arrears. In fact, just over a year before, The Gambia had been in arrears with the Fund, and because of this poor history, in discussing The Gambia's request for various Fund facilities last year, a number of Directors had expressed skepticism over its medium-term prospects. Currently, however, the staff reported unexpectedly high real economic growth, a marked decline in inflation, and a considerable reduction in external payments arrears, which it attributed to strict adherence to program policies.

The Gambian authorities had taken measures in 1985 to arrest the deteriorating economic situation in that country, primarily aimed at a more liberal pricing system, including the floating of the dalasi, the freeing of commercial bank lending rates, and the liberalization of rice imports, Mr. Lim indicated. Those were subsequently accompanied by other tough measures including reduction in government employment, and as a result, The Gambia was now faced with a more favorable medium-term outlook. Certainly more needed to be done in moving The Gambia away from an export structure dependent on one commodity, with a still large structural deficit. It was therefore encouraging that the measures supported by Fund programs were moving in that direction.

There were important lessons to be learned from the Gambian experience, particularly for a number of countries in the constituency to which The Gambia belonged, Mr. Lim declared. Those were the countries which had resisted taking politically difficult decisions on exchange rates, price liberalization, and fiscal compression, citing adverse social consequences as an excuse. The Gambian case demonstrated the ability of a resolute authority to attract donor countries' support, which in their circumstances might be crucial to generating a popular mandate. Certainly the small size of The Gambia and the modest amount of aid requested might have played a role in its success, but the bulk of the credit should go to the authorities' determination. The proposed decision was supported.

Ms. Bush complimented the authorities on the accomplishments of the past year, reflecting a case of solid adjustment. Their success had resulted from improved policies which had restored confidence among economic units both inside and outside the country. Prospects had changed remarkably since the decision a year ago to approve the extension of Fund credit simultaneously under three different facilities. At that time, prospects had appeared so bleak that Directors had noted the risk associated with such a large and rapid increase in the Fund's exposure. However, the confidence evidenced by such a commitment of resources was well deserved, as exhibited by the authorities' policies and by the performance of the economy.

Importance had been placed by both the authorities and the staff on the success of the floating exchange rate system that had been in effect since last year, Ms. Bush noted. Any comments from staff or from Mr. Abdallah on factors associated with the high degree of success achieved in that case, particularly in comparison with other cases in which similar systems had not fared so well, would be appreciated. Certainly, the exchange rate system played a critical role in the adjustment process, so the success was not a surprise. It was a pleasure to welcome The Gambia to the group of Fund members that had removed all restrictions on payments and transfers for all current international transactions.

In addition to the exchange rate system, fiscal performance was a factor behind The Gambia's success, Ms. Bush indicated. The implementation of such difficult measures as a reduction in government employment and the commitment to avoid salary increases was commendable. Further steps needed to be taken to eliminate the structural budget deficit, and the authorities should be encouraged in their efforts toward tax reform. It was notable that import duties would be reduced.

Given the excessively high rates of nominal taxation and consequent tax evasion, Ms. Bush inquired whether there was any scope for tax reductions. Was the entire tax system being studied, and was the Fund's Fiscal Affairs Department involved in such a project? Also, were there any plans to include measures on the tax system in the next structural adjustment arrangement? The reduction of subsidies of groundnut production was necessary if The Gambia was to maintain the pace of its adjustment efforts.

It would have been useful to receive information on whether the divestiture plan for parastatals or the review of the investment code were completed, Ms. Bush said. Such information would keep the Board informed on the progress of the structural adjustment arrangement. The authorities and the staff were encouraged to conclude expeditiously the second annual arrangement under the structural adjustment facility. She hoped that the objectives of the updated policy framework would reflect the potential that obviously existed in The Gambia for more ambitious objectives than those in the previous year's policy framework. If a follow-on stand-by arrangement were to materialize, consideration should be given to structuring such an arrangement not for actual use, but rather to act as a backup.

Mr. Kleine expressed support for the staff appraisal and for the proposed decisions. While the progress achieved during the past year was commendable, there was need for a continued good track record in the coming months in preparation for the next program. Also, the producer prices for groundnuts ought to be kept under close review in order to reduce subsidy payments as much as possible.

Mr. Arif said that the successes achieved by the Gambian authorities in various areas of economic management after the launching of the economic recovery program in 1985 and during the current stand-by arrangement were commendable, particularly the attainment of the March 1987 performance criteria, the high growth rate expected during the current year, and the continuation of the floating exchange rate.

In the fiscal area, the allocation for proper maintenance of the existing physical infrastructure was welcome because that was usually neglected in the race for new projects, Mr. Arif noted. The proposed fiscal reforms, including reduced reliance on foreign trade taxes and streamlining of the income tax law, would also be helpful. The projected increase in revenues in 1986/87 was reassuring, but the fiscal deficit as a proportion of GDP was quite high and needed to be reduced, as planned by the authorities. In that connection, the possibility of levying some new taxes or increasing the existing ones in appropriate cases might be examined periodically in order to increase self-reliance, since the general sales tax under consideration appeared to be aimed mainly at reducing dependence on taxes on foreign trade.

The producer price for groundnuts had been reduced by 16.7 percent for the 1987/88 crop and was projected to be readjusted further in the following year to completely eliminate the budgetary subsidies to producers, Mr. Arif continued. While it was a healthy move in principle, the impact of that price cut on the production of groundnuts had not been discussed in the staff report or background paper. The issue was important because the crop was projected to contribute about 9 percent of GDP in 1986/87, and export receipts from various products of groundnuts would form about 22 percent of total export earnings. Groundnut production also seemed to be quite price elastic since a substantial increase in the producer price for the 1986/87 season apparently had led to an increase of 22 percent in output. Perhaps the staff could throw some light on the implications, apart from decreased subsidies, of the proposed decreases in producer prices. Also, an explanation by the staff of the steps under way, or being contemplated, to tackle the problem of unrecorded transactions in international trade, as mentioned in the staff report, would be welcome.

The improvement in the Gambian economy in 1986/87 was due, to a considerable extent, to the relatively large external financial inflows, including grants and the very favorable debt rescheduling arrangement concluded in 1986, Mr. Arif pointed out. Those developments had reduced the Government's indebtedness to the banking system, making it a net creditor; had reduced the external arrears and debt service ratio; and had led to a net overall external surplus instead of the anticipated deficit, despite a higher than projected deficit in the current account. The authorities should continue strengthening the domestic resource base in order to be able to discharge the additional external obligations in the years beyond 1991 that were implied by the recent debt scheduling arrangement.

The staff representative from the African Department said that the impact of the recently reduced producer price of groundnuts on The Gambia's groundnut exports depended to a great extent on the producer price in its neighboring country, and that the situation in The Gambia could not be viewed in isolation. In 1986/87, the Gambian authorities had increased their producer price by 43 percent, but their neighbor had kept its price significantly above even that price. As a result, while there was a large increase in production in The Gambia, a significant proportion of exports were channeled unofficially through the neighboring country and not through the GPMB. The earnings were repatriated into the Gambian banking system, which was the principal reason for the improvement in the private capital account. The Gambia reduced its producer price by close to 17 percent for 1987/88, but its neighbor was retaining the producer price that had prevailed last year. As a result, The Gambia would probably ship even more of its exports through that country. If the exchange rate and interest rate policies in The Gambia were appropriately conducted, as in 1986/87, official groundnut exports would decline, but the balance of payments impact would not be negative, because unofficial export earnings would continue as before to come in through the private capital account.

While the authorities were trying to improve statistical coverage of the balance of payments, as suggested by Executive Directors, the administrative capacity of The Gambia was rather limited, the staff representative indicated. At present, two or three experts from the Central Banking Department's panel were trying to help the Central Bank improve statistical coverage, and they had already been successful in some areas. Cross-border trade was very difficult to monitor unless manpower was located throughout the country.

One Executive Director had asked whether a well-designed second-year program under the structural adjustment arrangement might not include reform of the banking sector, the staff representative recalled. Under the program for the first year, the "Managed Fund," whereby the Government took over a large amount of the nonperforming assets of The Gambia Commercial and Development Bank, had been implemented. During the second-year program, which would be discussed in early September with the authorities, it was intended to go further in the area of financial reform, particularly in the field of agricultural credit. A first-year action plan for agricultural credit reform was envisaged as a possible structural benchmark. Government bonds had been issued to the nonbank public, possibly in a higher amount than initially envisaged, and at an attractive interest rate of 21 percent, in order to absorb liquidity, the staff representative continued. Bond sales in the second half of June were equivalent to 7-8 percent of the base period money supply, and more might be issued in the following year.

An Executive Director had asked about the relative success of exchange rate policy in The Gambia compared with other countries which might have introduced a flexible exchange rate policy, the staff representative indicated. The Gambia's success had not been due to exchange rate action alone, but also to the fact that it had been buttressed by the flexible interest rate policy and financial restraint. Domestic credit had been initially programmed to decline by the equivalent of a third of the base period money supply, and the actual decline was considerably larger. The restraint exhibited by the Government in fiscal operations had also helped. In order to have a truly viable exchange rate reform with reduced restrictions on all current payments, appropriate accompanying policies in the financial area were necessary.

The Fund's Fiscal Affairs Department had been helping The Gambia to develop a tax reform to be implemented in 1987/88, the staff representative said. The reform would include a smaller number of tax brackets and reductions in the marginal tax rates as well as the introduction of a general sales tax.

A mission from the World Bank, with the purpose of assessing performance under the first year structural benchmarks listed in Table 10 of EBS/86/189, had returned to headquarters in early August, the staff representative from the African Department indicated. A thorough revision had been made of the investment code and it was expected that it would be adopted by the Government before the end of 1987. A large civil service retrenchment program had been carried out, details of which had been given during the last stand-by arrangement review, and a comprehensive multiyear administrative reform program had been prepared. Stringent criteria for project selection had been instituted for the public investment program (PIP), a PIP for 1986/87-1988/89 had been proposed, and a comprehensive plan for rationalizing the public enterprise sector had been adopted. Measures under that comprehensive program, such as the signing and implementation of performance contracts, would be structural benchmarks for the second year under the structural adjustment arrangement program. Specific proposals had been put forward for a reform of the income tax law and the implementation of a sales tax. It was hoped that those would be incorporated into the second-year program.

Ms. Bruns said that the World Bank was pleased with The Gambia's success under the structural adjustment arrangement.

Mr. Abdallah said that in addition to the points made by the staff representative, the success of the floating exchange rate system was also due to fiscal restraint; for 12 months the Government had been in a net creditor position to the banking system. There had been much opposition to the introduction of the floating exchange rate system at the beginning, but the Minister had been able to secure full political backing at the highest level, and the system had been accepted. In a small country, it was easy to identify those who were against the system and convince them of its merits.

Another reason for the success of the floating exchange rate system was that the trading and commercial life of the nation was not affected by political forces, Mr. Abdallah explained. In addition, there was only one large town in The Gambia, so that uniform rates for foreign exchange were obtained. The removal of restrictions on current account transactions virtually ensured that whatever had to be paid for foreign exchange could be immediately obtained at the local bank, and the small number of banks was also a convenience. Perhaps the Fund should try to promote floating exchange rate systems in small countries, where there were fewer potential problems.

The statistical problem of re-exports could not properly be addressed by the Gambian authorities until cooperation was achieved with the authorities of the neighboring country, Mr. Abdallah indicated. The Gambians were allowing free movement of goods and capital.

Although The Gambia had done very well in the past year and expected to repeat that good performance in the current year, the need for external financial support continued, Mr. Abdallah declared. He hoped that the donor community would continue to support the country to the same extent as previously. A one-crop economy was highly vulnerable, and everything must be done to help The Gambia to diversify. Fisheries offered the only prospect for diversification at present, but many international trawlers were operating off the waters of The Gambia. The Gambia's one patrol boat was permanently out of order, and international boats were claiming fish to which The Gambia was entitled.

The Chairman made the following summing up:

Directors were in broad agreement with the appraisal in the staff report for the 1987 Article IV consultation with The Gambia. They noted with satisfaction that the major objectives of the adjustment program for 1986/87 had been achieved. In particular, Directors cited the higher than anticipated rate of economic growth; the marked deceleration in domestic inflation; and the larger than expected increase in gross official foreign reserves and reduction in external payments arrears. Directors remarked that those favorable developments were associated with adherence to program policies, particularly the continued smooth functioning of the interbank exchange rate system and appropriate financial restraint, both of which had been buttressed by a more flexible interest rate policy. The budgetary outturn was broadly as planned. Also, although the growth in money plus quasi-money had been considerably higher than initially envisaged, it had stemmed entirely from an increase in net foreign assets and could be viewed as an indication of a financial deepening in the economy.

Directors welcomed the achievement of an overall balance of payments surplus, especially as, combined with a relatively high level of exceptional financing, it had afforded The Gambia the opportunity of effecting both a substantial reduction in external arrears and a much needed reconstitution of reserves.

Directors observed that preliminary indications for 1987/88 pointed to a satisfactory growth rate with the prospect of a further moderation in inflation. Moreover, present projections suggested the possibility of another balance of payments surplus. Directors cautioned, however, that realization of the above prospects and of a strengthened basis for sustained economic and financial improvement required a firm commitment to redress the sizable government subsidy in respect of groundnut operations through an appropriate reduction of the domestic producer price to bring it closer to the expected world market level, and to correct the still large budget deficit. Directors therefore welcomed the focus being placed by the authorities on those key areas.

Directors commended the authorities for their 1987/88 budget, which sought to curtail the deficit in accordance with their three-year (1986/87-1988/89) commitment. Directors remarked, however, that on the revenue side, further improvements in tax administration would be required. They also found merit in an early implementation of the proposed general sales tax and reform of the income tax law. Directors commented that the planned curtailment in the groundnut subsidy should help contain current expenditures at about their 1986/87 level. Directors also attached importance to the Government's decisions to forego a general salary increase for the public sector in 1987/88 and to limit increases in the wage bill. The relatively large increase in the budget for capital maintenance and the modest increase provided for new investment were considered appropriate.

Directors observed that despite the marked improvement in 1986/87, The Gambia's external position remained vulnerable and heavily dependent upon official transfers and concessional lending. That clearly called for further efforts to bring the current account to a sustainable level. In this context, Directors emphasized the need for the continuing rigorous implementation of policies under The Gambia's structural adjustment facility supported program.

There was agreement that the next Article IV consultation with The Gambia be held on the standard 12-month cycle.

The Executive Directors then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to The Gambia's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1987 Article XIV consultation with The Gambia, in the light of the 1987 Article IV consultation with The Gambia conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Gambia maintains the restrictive exchange measures described in SM/87/210, in accordance with Article XIV, Section 2, except that the restrictions evidenced by commercial external payments arrears and the multiple currency practice arising from the costs to purchasers of foreign exchange of counterpart deposits required for arrears are subject to approval

by the Fund under Article VIII, Sections 2(a) and 3, respectively. The Fund urges the authorities to remove these restrictions as soon as possible.

Decision No. 8686-(87/127), adopted
August 31, 1987

Review under Stand-By Arrangement

1. The Gambia has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for The Gambia (EBS/86/189, Sup. 2, 9/22/86) as contemplated in paragraph 4 of the letter of the Minister of Finance and Trade and the Governor of the Central Bank of March 19, 1987 attached to the stand-by arrangement, in order to review the progress made in the implementation of the program.

2. The letter dated July 21, 1987 from the Minister of Finance and Trade and the Governor of the Central Bank of The Gambia shall be attached to the stand-by arrangement for The Gambia and the letter of March 19, 1987 shall be read as supplemented by the letter dated July 21, 1987.

3. The Fund finds, pursuant to paragraph 4 of the stand-by arrangement, that the review contemplated in paragraph 4 of the letter dated March 19, 1987 is completed, and decides that no additional understandings are necessary.

Decision No. 8687-(87/127), adopted
August 31, 1987

2. BENIN - 1987 ARTICLE IV CONSULTATION

Executive Directors considered the staff report for the 1987 Article IV consultation with Benin (SM/87/211, 8/13/87). They also had before them a background paper on recent economic developments in Benin (SM/87/220, 8/21/87).

Mr. Santos made the following statement:

On behalf of my Beninese authorities, I would like to thank the staff for the constructive discussions they had in Cotonou in connection with the 1987 Article IV consultation. The views expressed in the staff appraisal in many respects concur with their own assessment of Benin's current economic and financial situation.

As underlined in the staff report, there is no doubt that the economic and financial situation of Benin remained difficult in 1986. Real GDP is estimated to have been stagnant and the overall fiscal deficit (on a commitment basis), including grants, increased. Moreover, the external sector further deteriorated with the current account deficit increasing sharply, and the debt service payments also increased. This economic picture is not expected to improve in 1987 and over the medium term.

To address the economic and financial problems facing the country, the Beninese authorities have set up a National Adjustment Committee which is expected to lay the foundations of a comprehensive adjustment program that could be supported by the Fund. The main features of such a program are well described in the staff report and I would just like to touch upon some of them for emphasis.

In the real sector, the authorities are giving priority to rural development with emphasis on projects related to the production of export and food crops. Through agricultural promotion and diversification, the authorities intend to achieve food self-sufficiency and to increase the supply of raw materials for local processing and for exports. With regard to the cotton sector which has significantly suffered from the sharp fall in world market prices since 1985, the authorities are taking steps to address problems in this sector, as described in the staff report.

The reform of public enterprises constitutes another priority of the authorities. As indicated in the staff report, the Government has already agreed on an action program for a study covering a sample of 11 enterprises with a view to either liquidating or rehabilitating them. It should be mentioned that in the meantime, some decisions have already been taken regarding these enterprises. Three of them, involved in shipping and transit, have suspended their activities and are being liquidated, and three others are in the process of being privatized. Furthermore, as part of its reform program, the Government has abolished the monopoly position enjoyed by the state enterprise in the importation and distribution of pharmaceutical products. In the industrial sector, the Government intends to place more emphasis on the promotion of small and medium-sized private manufacturing enterprises that could be a source of job creation for new graduates. To this end, changes in the investment code are being considered.

In the fiscal sector, the Beninese authorities have begun to take steps aimed at the achievement of a sustainable fiscal position over the medium term. This is not at all an easy task given the magnitude of the present disequilibrium between fiscal revenue and expenditure and particularly the modest additional revenue that could be expected from any improvement in tax administration. However, they have started their fiscal adjustment by revising the original 1987 budget. Under this revised budget, measures have been taken that entail significant cuts in current expenditure and increases in excise taxes on certain goods, such as alcohol, tobacco, and hydrocarbons.

The Beninese authorities are aware that a significant reduction in the fiscal deficit can only come about through efforts to minimize expenditures related to personnel. To this end, the Government has undertaken a census of the civil service and has announced the freezing of all recruitment. Given that salaries are relatively very low in Benin, the authorities' objective is to reduce gradually the number of civil servants instead of their wages. It is, however, to be borne in mind that this problem is a very sensitive one. In any case, the authorities are prepared to work closely with the Fund staff in finding realistic solutions to it. In this connection, they would carefully review the measures already proposed by the Fund staff (see page 13 of SM/87/211) in order to take them into account in the 1988 budget.

Regarding the domestic financial system, my authorities fully share the staff's concern about the difficult situation of the banking system. They are of the view that the banking system needs to be rehabilitated in order to support their adjustment efforts. It is in this context that the Government has commissioned a comprehensive study financed by the World Bank which is currently being undertaken by a team of experts.

In conclusion, I would like to reiterate my authorities' determination to address the economic and financial difficulties facing their country. They have taken important steps in that direction and intend to pursue discussions with the staff on a comprehensive program that could be supported by the Fund. It is clear that given the present difficulties, Benin will need the support of the international financial community.

Mrs. Ploix indicated that during 1986 and 1987, Benin's economic situation had continued to deteriorate. Without overlooking such adverse external developments as the sharp drop of world prices for oil and cotton, there was no question that the economic difficulties also stemmed from inadequate fiscal policies, inefficient public investments, and the automatic recruitment of graduates into the civil service. As far as Benin's future was concerned, the scenario presented in the staff report showed quite a grim economic forecast in the absence of an adjustment program.

Therefore, the staff analysis was accurate, especially on the urgent need for comprehensive adjustment measures, many of which had already been recommended in the staff report for the 1986 Article IV consultation, Mrs. Ploix declared. Among the actions necessary for a significant reduction of the fiscal deficit, the control and reduction of the wage bill should certainly be the authorities' top priority. The situation of the banking system was also worrisome, and called for prompt action. It was clear that there was no possibility of revitalizing the economy with a banking system in which two out of three deposit banks had suspended credit activities. Several recent studies could constitute a valuable basis for a program of action, and the authorities were strongly urged to move forward in that direction.

The staff report under discussion gave a more optimistic impression of Benin's outlook than the previous one, Mrs. Ploix noted. The discussions with the authorities had been much more open than before and it was clear that they sincerely intended to address the mentioned problems. The actions already taken to reduce the deficit of the cotton sector and to reform the public enterprise sector were welcome first steps. The conclusion of a program with the World Bank, for which credit had been approved in December 1986, was encouraging; she hoped that the program would be firmly implemented.

To translate those commendable intentions into action, the Beninese authorities were encouraged to pursue their discussions with the Fund in order to put together a comprehensive adjustment program which could be supported by a stand-by arrangement or by an arrangement under the structural adjustment facility, Mrs. Ploix concluded. As stressed in the staff report, such agreements with the Fund would provide the right signal to the international community and consequently elicit its financial support.

Mrs. Lundsager made the following statement:

> The staff report for this year's Article IV consultation gives some indication of progress in a few areas, but the overall financial situation remains precarious, with the country cut off from central bank credit and arrears growing, while economic growth is weak and export performance disappointing. In his statement, Mr. Santos reported that his authorities are aware of the problems and have set up a committee to work out a comprehensive adjustment program. This is welcome news, but time is of the essence, and we urge this committee and the Government to work expeditiously to fill in the details of such a program.
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> The centerpiece of such an effort clearly must be an improvement in the fiscal position. Strong actions to reduce the deficit are required, and while we recognize that the authorities are already taking some steps in that direction, apparently the deficit will not be reduced to the point at which it can be readily financed without an increase in domestic and external arrears. But besides some generalized expenditure reducing, and perhaps even revenue raising measures, the authorities need to address the structural imbalances created by the present breakdown of expenditures.

In particular, much stronger efforts will be needed to contain current expenditures, particularly through the wage bill, so that resources can be generated to support the investment budget and restore the flow of foreign project assistance requiring local counterpart financing. We recognize the difficulties associated with a change in the wage and hiring practices of the Government, but the wage bill consumes a very high proportion of government resources and cannot escape economy measures. It appears that hiring and promotion practices will have to change and wage levels may have to be rather constrained for some time, in order to improve the fiscal situation while encouraging searches for employment in the private sector.

The authorities have already begun an important supporting program in the public enterprise sector, which we hope to see broadened. With a number of entities already undergoing rehabilitation or being privatized, the role of competitive forces is being strengthened, which will help in the diversification effort. We note that changes in the investment code are under consideration and we recommend that the authorities seek the help of the Fund and the Bank in this area to determine the best method of encouraging local and foreign investment.

The authorities' moves toward agricultural diversification and growth will help generate employment and growth in the rural areas. We recognize that a transition to agricultural and private sector employment will take time, but the process must begin if there is to be a payoff in the medium term.

As these sectors develop, it will be critically important to have a sound banking system providing intermediation functions. When we last discussed Benin in April 1986, we were informed of a study prepared by the Banque Centrale des Etats de l'Afrique de l'Ouest. Now the World Bank is preparing a study and we wonder what additional areas are under review. When will actions be implemented?

A truly broad-based structural adjustment effort, encompassing fiscal consolidation and financial sector reform as well as sector-specific measures to encourage diversification is clearly needed. Exchange rate actions could help in this regard, although since such decisions are made at the level of the monetary union, the authorities must consider rather strong fiscal actions to restore financial equilibrium while freeing resources for the productive sectors. Such steps could help diminish the projected financing gaps in the medium term and could restore the confidence of donors and creditors, who might then provide additional concessional resources. Nonconcessional debt should be avoided. The authorities have chosen not to draw on Fund resources in the past, but we think that a structural adjustment arrangement, drawing on the combined expertise of the Fund and Bank staff, could help place the authorities' economic program in a structured, medium-term context, thus improving the chances of higher growth and a viable payments position being attained in the not too distant future.

Mr. Kleine said that the Beninese case was a very difficult one. It was particularly distressing to note that the overall economic outlook remained bleak. Therefore, the authorities' plan to start thinking seriously about the formulation of a comprehensive adjustment strategy was welcome. The various difficulties were well described in the staff report and in Mr. Santos's statement. The reform of the public service was particularly urgent, given the fact that expenditures related to personnel absorbed almost all government revenues. Realistic solutions had to be found to resolve such problems before the Fund could usefully engage its resources in an adjustment program that would be successful.

The staff representative from the African Department reported that the latest study on the banking system had been completed, with the help of the World Bank, and had recently been submitted to the Bank where it was being reviewed.

Mr. Santos recognized some concern on the part of Executive Directors regarding the authorities' present policy stance and the prospects for a speedy conclusion of discussions with the Fund on an adjustment program that could be supported by Fund resources. While the staff had emphasized the slow pace of those discussions, it had recognized that efforts were being made and it expected them to continue in the future.

The Chairman felt that Benin's economic situation was indicative of the benefits a member could derive from cooperation with the Fund.

The Chairman made the following summing up:

Executive Directors generally agreed with the thrust of the staff appraisal and expressed deep concern about the extremely difficult and deteriorating economic and financial situation facing Benin. They urged the Beninese authorities to adopt a comprehensive adjustment program that could improve the external position and lead to economic recovery.

Directors noted that the major objective of an adjustment program should be to sharply reduce the fiscal deficit by simultaneously reducing expenditure and intensifying efforts to raise revenue. Directors emphasized the urgency of bringing expenditure under control. They noted the need to take immediate action to reduce the wage bill and the high number of civil servants.

Directors commended the authorities for the efforts being made to rehabilitate the state enterprise sector, under the World Bank-financed project. Directors also urged the authorities to act decisively to reform the banking system.

Directors stressed the importance of the determined action taken by the authorities to address the financial difficulties of the cotton sector, in particular, the difficult decision to lower producer prices. Directors urged the authorities to intensify their efforts to restructure the economy toward sectors, especially agriculture, which are capable of generating sustained growth.

Directors expressed the hope that the authorities would urgently formulate a comprehensive program of action that could be supported by the use of Fund resources, particularly under the structural adjustment facility. They also noted the importance of concessional financing in view of the high external debt service burden.

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

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LEO VAN HOUTVEN
Secretary