

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/65

10:00 a.m., April 29, 1987

M. Camdessus, Chairman

Executive Directors

A. Abdallah

A. Donoso

M. Finaish

A. Kafka

H. Lundstrom

H. Ploix

G. A. Posthumus

G. Salehkhoul

Alternate Executive Directors

E. T. El Kogali

Song G., Temporary

M. K. Bush

M. Lundsager, Temporary

H. G. Schneider

R. Morales, Temporary

T. Alhaimus

B. Goos

A. Bertuch-Samuels, Temporary

D. V. Nhien, Temporary

M. Foot

D. McCormack

C. V. Santos

I. A. Al-Assaf

E. Ayales, Temporary

S. de Forges

C.-Y. Lim

O. Kabbaj

M. A. Hammoudi, Temporary

L. E. N. Fernando

K. Murakami, Temporary

F. Di Mauro, Temporary

L. Van Houtven, Secretary

V. Wall, Assistant

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Also Present

IBRD: L. E. Hinkle, Western Africa Regional Office; P. Eigen, Latin America and the Caribbean Regional Office. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; D. T. S. Ballali, J. A. Clement, S. E. Cronquist, A. Doize, K. Enders, S. M. Nsouli, D. J. Ordoobadi, L. S. Schmitz. Exchange and Trade Relations Department: S. J. Anjaria, E. Brau, J.-C. K. Brown, N. Kirmani. External Relations Department: H. P. Puentes. IMF Institute: S. Coulibaly, Participant. Legal Department: H. Elizalde, S. A. Silard. Research Department: H. C. Kim. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. Berthet, J. C. Corr. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; A. Arbulu-Neira, P. D. Brenner, M. Caiola, H. M. Flickenschild, J. Jaramillo-Vallejo, J. E. Leimone, C. M. Loser, F. van Beek. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: M. B. Chatah, L. P. Ebrill, S. M. Hassan, G. D. Hodgson, J.-C. Obame, P. Péterfalvy, D. C. Templeman, A. Vasudevan, K. Yao. Assistants to Executive Directors: A. R. Al-Abdullatif, J. R. N. Almeida, E. C. Demaestri, F. Di Mauro, M. Hepp, G. K. Hodges, O. Isleifsson, A. R. Ismael, J. M. Jones, M. A. Kyhlberg, V. K. Malhotra, T. Morita, C. Noreiga, S. Rebecchini, V. Rousset, G. Schurr, D. A. Woodward.

1. MALI - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Mali (SM/87/81, 4/3/87). They also had before them a background paper on recent economic developments in Mali (SM/87/89, 4/16/87).

Mr. Santos made the following statement:

The Malian economy has been beset by structural rigidities that have been compounded in recent years by a sharp decline in the price of cotton, its major export, and unfavorable weather conditions. To mitigate the combined adverse effects of these exogenous factors, the authorities undertook strong adjustment programs with the support of the Fund and the World Bank. These sustained efforts together with better weather conditions have, in 1986, contributed to a reversal of the downward trend in economic activity and to a reduction of the internal and external imbalances.

Developments in the real sector were favorable in 1986. Real GDP grew at a stronger pace than anticipated while inflationary pressures subsided. These favorable developments were attributable to the revival of the agricultural sector owing to higher producer prices and good rainfalls as well as to a recovery of industrial production. The strong expansion of these sectors more than offset the slowdown in the service sector. Significant progress was made in the restructuring of the economy as a result of the authorities' sustained efforts to reduce the economic distortions particularly in the agricultural sector. Faced with a large deficit in the cotton sector caused by the sharp drop in the price of cotton (43 percent), the authorities promptly took the appropriate steps to reduce it to a manageable level. These measures included not only a reduction in input subsidies, but also the abolition of the monopoly advantage of SOMIEX for the exports of cotton as well as cuts and deferral in expenditure and remunerations of state enterprises involved in the cotton sector. Moreover, marketing and pricing policies were further liberalized in order to enhance economic efficiency and to improve resource allocations. Regarding the public enterprise sector, while assessing thoroughly the need for a major reform of this sector, the authorities have reduced substantially the role of a number of state enterprises in the economy. With regard to SOMIEX, personnel was reduced by one third, its monopoly and monopsony positions were abolished for imports and distribution of major commodities.

The authorities' efforts to implement a cautious financial policy in 1986 were hampered by adverse developments in factors beyond their control such as the above-mentioned sharp fall in

export price of cotton and lower level of external financial assistance. In anticipation of the shortfall in cotton revenue estimated at 7 percent of total revenue, the authorities took additional fiscal measures such as increasing the "valeur mercuriale" by 21 percent and shifting the basis of customs duties from indicative to real value. These additional measures have accounted for a 32 percent increase in noncotton revenue. As a result, total revenue reached a level higher than envisaged. However, the fiscal difficulties were compounded by overruns in expenditures and by lower grants than anticipated, thereby leading to increased Government borrowing from the banking system. The elimination of all arrears, both domestic and external, remains a major objective of the Malian authorities. In that regard, efforts are being made to monitor closely expenditures and make the Treasury not accountable for nonbudgeted expenditure. Furthermore, a commission has been set up to identify, verify, and clear all arrears.

As reported by the staff, the external position improved as evidenced by the substantial decline of current account deficit, excluding grants. The improvement in the current account took place despite an 18 percent fall in export earnings, due to the sharp drop in cotton export prices. Reflecting the good harvest, cereal imports fell also in 1986.

Turning to the medium-term outlook of the Malian economy, the staff's scenarios clearly underscore the urgency to consolidate the gains achieved so far by following a prudent demand-management policy and pursuing the restructuring of the economy. My authorities share the staff's concern about the difficult prospects of the Malian economy and agree that corrective measures are needed to improve the economic situation. They also recognize that there is an urgent need to contain the growth in government expenditure and to address the liquidity problem confronting the banking system by restructuring major state enterprises.

In examining the policy stance of the Malian authorities, it is important to recognize the substantial progress they have achieved over the past few years under previous stand-by arrangements as evidenced by key policy measures implemented that are summarized in Table 2, page 6, of the staff report. Therefore, the more cautious approach being followed should not be construed as a reluctance to address the problems confronting the country. The measures recommended by the Fund and the World Bank are far-reaching and would bring about a fundamental change in the structure of the economic system. The Malian authorities' resolve to take appropriate steps toward reducing the economic distortions has not faltered. However, the implementation of such measures requires a political consensus that takes time to emerge. In view of the social and political implications of the

reforms to be undertaken, they believe that the scope and speed of the adjustment need to be carefully examined with a view to making it socially and politically feasible.

Mr. Abdallah made the following statement:

The economic situation in Mali remains difficult, and calls for forthright action on the part of the authorities. However, adjustment programs in economies where the export sector is dominated by one or two primary commodities is not an easy task; indeed, it is not even easy in developed countries, which are less vulnerable to exogenous developments. The staff report did not sufficiently appreciate the predicament of the authorities in trying to work out an adjustment program to deal with their problems. The staff paper suggests that the authorities are reluctant to undertake adjustment measures. However, the far-reaching reforms that were put in place in the first half of 1986 indicate that the authorities are fully aware that they must implement changes. The slippages that occurred emerged only in the second half of the year, and these were associated with the further decline in the price of cotton--Mali's major foreign exchange earner--and with shortfalls in anticipated external assistance. Since prices of cotton have improved, there is hope that the overall financial situation will get better.

Of course, additional corrective action is necessary. However, far-reaching structural reforms will succeed only if they are supported by a political consensus, which requires time. Experience shows that policies aimed at reducing the public sector work force or closing down public enterprises are not popular. Frequently, the staff expects too much too soon from structural reforms in countries with fragile economies.

The staff report draws the authorities' attention to a number of key issues that must be tackled if the economy is to move toward equilibrium. The financial position of the public sector must be improved, including the rationalization of public enterprises, in order to develop a public investment program that is aimed at economic diversification, that is consistent with the availability of financial resources, and that will encourage private sector activity through appropriate pricing and other incentives. Progress along those lines will mitigate the impact of adverse exogenous forces. Fund assistance in Mali perhaps might be more effective if economic programs focused on adjustment over the medium term rather than the short term, as with a traditional stabilization program. I wonder whether a program under the structural adjustment facility has been considered.

Mr. Alhaimus made the following statement:

Economic developments in Mali during 1986 were obviously mixed. On the positive side, the objective of a high economic growth rate was achieved, with the help of a good agricultural season, and the inflation rate was further reduced. On the negative side, however, both the fiscal and external imbalances were larger than projected, although still remaining somewhat below the 1985 levels. Furthermore, there had been a shift toward more accommodating fiscal and credit policies in the second half of 1986, which had contributed to the interruption of Mali's adjustment program with the Fund.

Against this background, the most pressing policy issue is to bring the adjustment effort back on track and thus ensure the flow of much needed assistance to the Malian economy. Unless corrective policies are taken promptly, Mali will confront a serious economic and financial crisis. A comprehensive list of such measures, which the authorities do not question, has been identified in the staff report, and some of them have already been embarked upon. The main question is what the authorities can do in the difficult circumstances and given the general situation in the country.

Following three years of drought, the country had to face a sharp drop of about 40 percent in the price of cotton, the country's major export. The implications for exports and fiscal revenues are significant, as is the shortfall in budgetary assistance. Nevertheless, the authorities strived to keep up the momentum of adjustment, even though it entailed adopting additional adjustment measures. They were widely commended for this courageous stand by the Board in its discussion of the second review of the stand-by arrangement in September (EBM/86/160, 9/19/87). One therefore wonders why, after such a good track record since 1982, policies were reversed in mid-1986. Perhaps the new burdens were overwhelming. In such circumstances, program objectives and policy expectations should be adjusted to take into account the real limits of adjustment policy. In such circumstances, additional financing should also be sought. During the Board's discussion on Mali in September we wondered how such economies could possibly "keep adjustment programs on track without additional contingency financing in cases of setbacks such as a sharp fall of a major export product."

It may also be necessary to implement sensitive structural measures, such as the dismantling of state enterprises, flexibly. Mali has already taken many but not all of the required steps to dispose of Air Mali and SOMIEX, the state trading company. Future programs, however, should allow the authorities to determine the appropriate timetable for eliminating the financial burden of public enterprises, and programs should not rigidly

predetermine the course of adjustment. Finally, I hope that urgent action can be taken to put in place a structural adjustment arrangement for Mali because it is a very suitable candidate. The staff referred to such an arrangement in the staff report for the Board discussion of the review of Mali's stand-by arrangement, but hardly any mention was made of it in the staff report under discussion.

Mr. Bertuch-Samuels made the following statement:

The contrast between the economic situation in Mali described in the current staff report and the one at the time of the second review under the recent stand-by arrangement is striking and, indeed, disappointing. In the earlier staff paper significant improvements on all fronts had been projected by the staff: a continued reduction of domestic and external imbalances, a strong growth of economic activity, and a decline in the rate of inflation--all against the background of continued progress in structural reform. Currently, however, the staff considers the country to be on the verge of a major economic and financial crisis.

One might put the blame for what happened on the sharp decline in the export price of cotton. But the staff's projections of July 1986 had already taken this factor fully into account. Moreover, the authorities had previously displayed a great deal of flexibility in adapting to adverse external developments and had indicated that they would further strengthen their adjustment program in order to overcome the problems in the cotton sector--policy intentions that, at the time, evoked widespread praise from the Board.

One might also regard the shortfall in net external financing as contributing to the deterioration of Mali's financial situation. But while this may have aggravated the liquidity problems faced by the Treasury, it does not by itself explain the magnitude of the financial imbalances that emerged in the second half of 1986. The staff's analysis--especially in Table 2 in the staff report--on the implementation of adjustment and reform measures sheds more light on the situation. Notwithstanding the number of measures listed as "implemented," there were many serious slippages, most notably in fiscal and credit policy, the public enterprise reform program, and the failure to prepare a comprehensive public investment program. I share the staff's view that it was mainly because of those slippages that the program's targets were missed and that the economic and financial situation in Mali deteriorated during the second half of 1986.

To be sure, the authorities achieved commendable progress in a number of areas related to structural reform. Moreover, the buoyancy of economic activity and the drop in the rate of inflation during 1986 are welcome. It is clear, however, from the alternative medium-term scenarios that, given the underlying imbalances and structural problems, Mali would not be able to maintain a sufficient and sustainable rate of growth and achieve a viable external position, unless corrective measures embedded in a comprehensive medium-term adjustment program are taken promptly.

Against this background, I find it difficult to understand the authorities' apparent procrastination at present--especially since they obviously recognize "that the slippages in 1986 have led the economy to the verge of a major crisis."

I sincerely hope, therefore, that the authorities will quickly return to the ambitious policies of adjustment and reform that they have pursued since 1982 in close collaboration with the Fund and the World Bank and map out an adjustment strategy of the kind suggested by the staff. The measures outlined by the staff need to be implemented with a sense of urgency if the progress made under previous adjustment programs is not to be quickly eroded. In this context I welcome the indications in Mr. Santos's opening statement that his authorities' resolve to take appropriate steps toward reducing the economic distortions has not faltered. I therefore wonder whether the authorities could not make a determined effort to negotiate with the staffs of the Fund and the Bank a medium-term policy framework and an adequate financial program for 1987/88 that could lay the basis for an arrangement under the structural adjustment facility, which would be the appropriate means to bring the Malian adjustment efforts back on track and help the country attain a viable external position over the medium term.

Mrs. Ploix made the following statement:

The staff report for the second review of Mali's stand-by arrangement presented the picture of a country that was well on the way to reducing its imbalances and creating conditions conducive to a modest but sustainable growth of GDP. At present the picture appears different. Substantial slippages have occurred in the fiscal area, and delays in the implementation of the scheduled structural policies could jeopardize the results of three years of progress. These developments are all the more regrettable since much progress has been made in the past three years. Regarding financial policies, the deficit of the consolidated account of government operations has been narrowed from 9.4 percent to 6.9 percent of GDP, thanks to strong efforts



made on the revenue side. On the structural side, the gradual price and marketing liberalization, combined with the increase of producer prices and the launching of a restructuring program for cotton, has yielded encouraging results. Six public enterprises have been liquidated, while the financial situation of others has improved through tariff increases and reduction of personnel.

The slippages are related to two main areas. Budgetary expenditures have greatly increased owing to unforeseen overruns--24.5 percent in 1986--which has led to a broadening of the financing gap and to the accumulation of new arrears. As an immediate consequence, Mali was unable to make the last two purchases under the stand-by arrangement. Furthermore, the pressure put on the financial sector could soon become disruptive. On the structural front, the implementation of the public enterprises rehabilitation program, to be supported by the World Bank, is at a standstill.

Those developments do not only affect the short- but also the medium-term prospects, as clearly demonstrated by the scenarios provided in the staff report. Chart I, page 14, is particularly explicit in this respect. If a relaxation of Mali's adjustment effort were to persist, the external gap could reach more than CFAF 30 billion in 1987. An accumulation of internal and external arrears--and the lowering of external assistance that would come with it--would thus be difficult to avoid and would have an adverse impact on economic activity. Under this scenario, Mali's prospective growth rate would be well under the population growth rate and would result in a reduction of GDP per capita. No prospects for reaching a viable balance of payments situation could be envisaged in this situation.

However, that scenario is not inevitable. A resumption of medium-term adjustment policies could generate an annual growth of real GDP of 3.5 percent while making it possible to eliminate the financing gap of the balance of payments by 1990. The scenarios described in the staff report are somewhat simplified; but they show that Mali cannot avoid implementing a consistent set of adjustment policies.

I share the staff's views on the need for implementing adjustment policies and encourage the authorities to work closely with the Fund and the World Bank to decide on a new adjustment program, which should address three main issues. The first priority is the strengthening of public resources management. The recent slippages demonstrate an urgent need to establish strict control of budgetary expenditures, both current and capital. Extrabudgetary expenses should be eliminated, payment arrears should be identified and eliminated, and a three-year public investment program should be established to improve the efficiency of investments.

The second priority is a comprehensive reform project for the public enterprise sector, including the reform of Mali's development bank. Unless the authorities dismantle the public enterprises, Mali will continue to face budget and credit pressures. Of course, this reform should be implemented within the framework of the continued liberalization of the price and marketing arrangements.

The third priority is to restructure the cotton sector.

Mali is at a crossroads, and time is of the essence. Thus, I encourage the authorities to move forward as quickly as possible and resume discussions with the Fund and the World Bank.

Regarding World Bank assistance, substantial resources have been earmarked for public enterprise sector operations. Should the launching of this project experience additional delays, these resources could well be redistributed to other countries.

If Fund assistance is requested by the Malian authorities, I would favor the extension of a new stand-by arrangement and an arrangement under the structural adjustment facility.

Mr. Al-Assaf made the following statement:

Since 1982 the Malian economy has been on a path of adjustment that has been buffeted by unforeseen adverse shocks. Most of the time the authorities have responded flexibly by intensifying their courageous adjustment efforts.

Recently, however, slippages in policy implementation and economic imbalances are increasing, as documented in the staff report. The authorities need to address the emerging economic problems of the country as soon as possible, which will place demands on Mali that will be painful in light of the limited resources available. However, the hard-won gains of the past couple of years will be reversed, with the prospect of even more painful adjustment in the future, unless action is taken and the continuity of adjustment is ensured. In this connection, I am encouraged by Mr. Santos's opening statement that the Malian authorities are resolved to take appropriate steps toward reducing the economic distortions.

There are many advantages to setting Mali's adjustment efforts in a medium-term framework. In this connection, a structural adjustment arrangement would appear appropriate, and is, in fact, contemplated.

Progress has been made in restructuring the public enterprise sector. By mid-December 1986, six of the enterprises had been liquidated with various others, including notably Air Mali, being on the road to either liquidation or privatization. However, much more remains to be done. The study on the state trading company has been completed, and I wonder if either the staff or Mr. Santos could present an update on the authorities' intentions in this connection.

The authorities need to reinforce their efforts to restrain the deficit, an objective that could usefully be supplemented by policies aimed at enhancing economic incentives, in general, and at stimulating savings, in particular. I note from Table 8 of the background paper a surprising inelasticity of revenues from taxes on net income and profits. This inelasticity, I suspect, is due to Mali's schedular system of income taxation. Schedular taxes are hard to administer, raise questions of equity, and can result in broad disincentive effects. A simplified global approach might well be preferable and could be introduced in the context of a medium-term plan.

Mali has recently accumulated external arrears; however, the financial program calls for the elimination of external arrears that have been accumulated in 1986. To resolve the internal and external arrears problem the authorities must back up a cautious fiscal policy with a tight credit policy.

The Malian economy has reached a juncture that calls for the adoption of a comprehensive adjustment program. Failure to act decisively at this stage will jeopardize the gains of earlier years. For its part, the Fund should stand ready to provide support to facilitate the country's adjustment efforts.

Ms. Lundsager made the following statement:

In many respects the Malian authorities were making impressive progress under the stand-by arrangement through the first half of 1986. Some far-reaching structural reforms were generating a turnaround in real economic activity, with the help of good weather, and as a result, real economic growth of almost 10 percent was achieved last year. Unfortunately, this turnaround may not be sustained, given the marked deterioration in the financial environment, with the fiscal deficit exceeding the target, arrears accumulating, the public enterprises running losses, and credit expanding rapidly. This deterioration, if not addressed quickly, could rapidly undo the improvements that occurred earlier. The risks of proceeding without adequate policies are shown in the scenarios presented in Chart 1 in the staff report and in the medium-term outlook: lower growth rates and larger

financing gaps that probably will mean import compression and disorderly domestic adjustment. Instead, a return to fiscal and monetary restraint, supported by further needed structural reforms, can best secure lasting growth in the context of a viable balance of payments position.

The needed adjustment measures are clearly laid out in the staff report and, indeed, the Board has discussed the issues on many occasions. While the efforts being made to liberalize pricing and marketing arrangements are welcome, additional steps toward decontrol are needed in order to stimulate the additional private sector activity that could be the foundation for sustainable growth in the medium term. Policies must be more consistently implemented; for instance, it was discouraging to learn that while import monopolies on several items had been abolished for procedural reasons--a welcome step--no licenses to permit imports of those products were issued to the private sector, undercutting the effectiveness of the liberalization measures.

The public enterprises continue to exert a drain on the economy, and we urge action to rehabilitate those that do remain in the public domain and to divest those slated for privatization. For several years, the liquidation of Air Mali has been an issue in the Board's discussions of Mali. The time is long past to finalize this measure. In addition, the banking system still appears to be weak, and if agriculture and other sectors are to be effectively restructured, a sound commercial banking system must be there to provide intermediation services.

Of equal importance, however, is a sound financial environment. Without a financed public sector deficit, arrears accumulate and suppliers suffer. Spending on extrabudgetary items will not be sustainable in the medium term, and thus conservation must begin now. The tax reform effort is of very high priority to my own authorities, who are supporting it directly with grant financing, and we hope to see continued progress. But my authorities also look at the overall macroeconomic environment in a recipient country. The United States' Economic Policy Reform Program, mentioned in the staff report, provides assistance to countries adopting comprehensive economic adjustment programs, even if the particular support we provide is targeted on one area, in this case tax reform. For that reason, a country's overall economic policy environment is considered in determining U.S. assistance under this program, and in that respect, concerns have arisen regarding the overall fiscal and monetary policy stance in Mali.

In conclusion, we would hope to see the authorities and the Fund and Bank continue discussions in near future, with the aim of restoring the momentum of adjustment. In that regard, the

authorities must themselves work on developing the domestic consensus in order to carry through on their "resolve to take appropriate steps." This would enable the World Bank and the Fund to provide financial assistance, through the structural adjustment facility, for instance, which could help bring about a more favorable path of growth and development.

Mr. Hammoudi made the following statement:

The staff report indicates that notwithstanding the adverse effects of the world economic situation and international trade, there have been large-scale efforts by the authorities to achieve the objectives targeted by the Fund. The implementation of wide-ranging structural measures, together with a return to more normal weather conditions, have allowed Mali to achieve an increase of 9.6 percent in real GDP and to maintain a rate of inflation below the program target of about 6.5 percent in 1986. The authorities have addressed underlying economic and financial imbalances by reducing the expenditures of major public enterprises, thus releasing resources for private sector and liberalizing the trading and pricing system.

However, the authorities have encountered many difficulties. Three major developments hampered government action: the drought in 1984/85, the sharp decline in cotton export prices in the last quarter of 1985, and the shortfall in external budgetary assistance.

Despite adverse exogenous factors such as a sharp deterioration in the terms of trade, the authorities have continued their adjustment efforts supported by the Fund. It is important that the Fund continues its support for Mali to achieve its economic and financial objectives. The failure in the implementation of some measures was due to technical problems rather than to the lack of will on the part of the authorities. Moreover, the difficult economic situation explains the nonachievement of certain objectives, especially in the financial area.

In spite of a drop in the cotton export prices of about 40 percent, which reduced revenues sharply, the Government has had to fulfill its internal financial commitments for social and political reasons.

The measures undertaken and the courage demonstrated by the authorities in implementing such actions deserve our commendations, because they impose severe restrictions on people with basic needs, especially in the face of three years of drought and austerity.

The authorities appear committed to implement measures under the adjustment program for 1987 by managing the budget strictly, by enacting tax reform, by restructuring the public sector, and closely controlling the bank system. In this regard, the Government will control the allocation of credits strictly under the supervision of the Central African banking system.

The nonagricultural sector is improving, and the Government is encouraging industrial activity to offset the difficulties met in the agricultural sector and in the public sector.

I concur with the regular 12-month cycle for the Article IV consultation with Mali.

The staff representative from the African Department remarked that the comments of the Executive Directors concerned three major issues: the evolution of the Malian economy in 1986, the status of negotiations with the Malian authorities, and the possibility of a program supported by the structural adjustment facility.

The authorities had faced a major challenge with the fall in the price of cotton exports, the staff representative commented. The program in support of the stand-by arrangement had taken that development into account and included a comprehensive program for the cotton sector, which had been implemented as envisaged. Indeed, despite the fall in cotton prices, both exports and budgetary revenue performance were on track, with exports growing in line with projections of 18 percent and revenue growth exceeding the projected rate of 24 percent to reach 25.2 percent. However, slippages had occurred on the expenditure side and expenditures had grown by 24.6 percent instead of the 10.4 percent programmed. Credit policy had also been considerably more expansionary than planned. While the targets for credit for end-March and end-June 1986 had been met, in the second half of the year credit control had been relaxed, and overall credit had expanded sharply. As a result, instead of growing by 8 percent as originally expected, overall credit had grown by 18.5 percent.

Reflecting essentially these slippages in the implementation of fiscal and monetary policies, imports had been higher than programmed, and the balance of payments objective was not achieved, the staff representative noted, although the balance of payments outturn did present an improvement over the previous year. However, reflecting the good weather conditions and the structural measures taken in the first half of 1986, the rate of inflation had declined, and the economy had recorded a healthy growth rate of almost 10 percent.

A detailed financial program for 1987 and a draft of a policy framework paper that could be used as the basis for a structural adjustment arrangement had been discussed with the authorities, the staff representative stated. The staffs of the World Bank and of the Fund had

collaborated closely in the preparation of the public enterprise reform project, which had been reviewed with the Malian authorities. The authorities understood that the economic situation was changing rapidly and that there could be a serious retrogression in the progress that had been made over the previous few years. An inter-ministerial committee, chaired by the Prime Minister, and including the Ministers of Finance, Plan, Industry, and State Enterprises had been established to review, by May or June of 1987, the policies needed to redress the economic and financial imbalances.

The Minister of Finance wished to pursue a prudent fiscal policy and had already taken a number of steps, as indicated in the staff report. In particular, he had strengthened the control over civil service salaries based on the recent census of government personnel and had reduced the irregularities in salary payments. The authorities estimated that savings of as much as CFAF 2 billion could be realized. Travel also had been subjected to much more rigorous control than in the past, and per diem payments had been reduced sharply. The importance of recording extrabudgetary expenditures had also been taken into account by the authorities, and the Prime Minister had issued a circular to all Ministers requiring them to adhere to budgetary procedures and prohibiting them from incurring extrabudgetary expenditures. The Minister of Finance had announced in the local news media that the Government would not be responsible for the payment of bills that had not been subjected to the regular budgetary procedures. A number of steps had been taken to improve revenue performance, especially improvements in tax administration.

A study of the state trading company had been prepared with technical assistance from China, the staff representative commented. The study had not yet been seen by the staff, but the authorities were considering the possibility of a joint management arrangement with China, in order to improve the financial and economic position of the state trading company.

The strategy outlined in the policy framework paper aimed at promoting private sector economic activity and reducing both the structural distortions and financial imbalances facing the economy, the staff representative continued. Agricultural policy would be geared to diversifying and promoting agricultural production; in this regard, a comprehensive medium-term plan of action for the cotton sector was essential. Pricing and marketing policies also needed to be further liberalized. The key element of the medium-term structural adjustment strategy was reform of the public enterprise sector. A comprehensive program had been prepared in collaboration with the World Bank.

The strengthening of the overall fiscal position was of particular importance, the staff representative noted. In that connection, the authorities needed to simplify the tax system with a view to improving its elasticity and eliminating its distortions. The Fund had provided

technical assistance in that area, and a report had been prepared. Furthermore, some tax measures had been put in place with financial assistance from the United States. On the expenditure side, the problem of the large wage bill needed to be addressed. The authorities were preparing a study that should provide a foundation for adopting specific wage and price policies. In addition, there was a need to provide for increased allocations for maintenance. An improvement in the budgetary position, resulting from expenditure and tax measures, would allow a more flexible credit policy to the productive sectors to be pursued, thereby enhancing growth prospects.

There was considerable preparatory work to be done before a policy framework paper could be finalized, the staff representative from the African Department said in closing. The adoption of the public enterprise reform project and the development of a three-year public investment program were important ingredients. The authorities also needed to complete the study on the role of the cereal marketing agency and to determine their strategy for cereal marketing in the country. Finally, the volume of outstanding cross arrears had to be verified and a timetable for their elimination adopted.

Mr. Santos remarked that although progress had been made on correcting internal and external imbalances under the previous stand-by arrangement, much remained to be done. Therefore, the authorities must pursue their adjustment efforts. The recognition by the Board of the progress made by the authorities under difficult circumstances had provided encouragement to them to pursue the necessary adjustment for sustained growth.

The Chairman made the following summing up:

Executive Directors concurred with the thrust of the views in the staff appraisal. They noted that with the sharp decline in the export price of Mali's main export commodity--cotton--on which the Malian economy remains highly dependent, the authorities had promptly readapted their policies early in 1986 to keep the adjustment process on track. While satisfactory progress was made in the first half of 1986, and all the performance criteria through end-June 1986 were observed, Directors regretted that the economic and financial policies were significantly relaxed in the second half of the year. While the favorable weather conditions and the structural measures taken contributed to a sharp rise in the rate of economic growth and a drop in the rate of inflation, the program objective for the external sector position was not achieved owing to the slippages in policy implementation in the second half of the year, notably in government expenditure and domestic credit.

On the structural front, Directors welcomed the progress made in 1986 in several areas, but they regretted that these were not continued in the second half of the year. Directors



noted with concern that the work to develop a three-year rolling public investment program lagged behind schedule and that it was critical to elaborate that soon. The difficult fiscal situation, accompanied with continuing losses in the public enterprise sector, had placed considerable pressures on the banking system, contributing to an overshooting in credit expansion.

Directors noted that in view of the aforementioned slippages and the weakness in the world demand for cotton, the prospects for 1987 and the medium term are not encouraging, and there was now a risk that the major efforts made over the past several years would be jeopardized. Directors expressed concern that the Malian authorities have not as yet formulated specific policies to meet this challenge, and there was now the prospect of a major external financing gap and rising payments arrears in 1987 and beyond. They urged the Malian authorities to map out and to implement a comprehensive medium-term strategy in order to lay the foundation for reducing the financial and structural imbalances and achieving a sound and sustainable growth rate. Personally, I would like to note that the medium-term macroeconomic analysis contained in the staff report illustrates eloquently that a well-conceived adjustment strategy would lead to economic growth.

Directors urged the Malian authorities to take promptly, within the context of a medium-term framework, corrective measures to avert a serious economic and financial crisis in 1987. On the financial front, they emphasized the need to pursue a prudent budgetary policy and a balanced credit policy. In this context, they underscored the importance of eliminating all extrabudgetary expenditures and of improving the soundness of the domestic banking system. To make further progress in alleviating the structural constraints, Directors indicated that it was essential to reduce further the scope of pricing and marketing controls. In addition, Directors urged the authorities to launch the comprehensive reform project for the public enterprise sector and the economic and financial plan for the cotton sector, both of which have been prepared with the assistance of the World Bank.

In conclusion, Directors stressed that renewed and sustained adjustment efforts by the authorities would need to be supplemented by continued donor assistance in the years ahead, and they urged the authorities to develop a medium-term policy framework that could form the basis for Fund support under the structural adjustment facility or, possibly, as it was also observed, in the form of a stand-by arrangement.

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

## 2. PERU - OVERDUE FINANCIAL OBLIGATIONS - REPORT BY MANAGING DIRECTOR

The Executive Directors considered the report by the Managing Director on Peru's overdue financial obligations to the Fund and Peru's relations with the Fund (EBS/87/89, 4/27/87; and Sup. 1, 4/28/87).

Mr. Morales said that the recent exchanges between the Managing Director and the Peruvian authorities were welcome. A frank dialogue had been established, which had led to the Managing Director's report. His authorities felt that those developments should be seen as an indication of their commitment to the Fund. As mentioned in the telex to the Managing Director, the aspirations of the people of Peru coincided with the objectives set forth in the Articles of Agreement. Policy dialogue between the authorities and the staff should prove to be a valuable tool that would help to assess the economic difficulties and social unrest that Peru had faced during recent years and that the Government was trying to overcome. Continuation of intensive dialogue would also help return Peru to a normal relationship with the Fund. In that connection, he was in agreement with the decision.

Mr. Kafka remarked that he supported the staff's pragmatic proposal.

Mr. Ayales noted that since the Board's previous discussion on Peru's overdue financial obligations to the Fund, the Managing Director had been successful in making progress toward restoration of normal relations between Peru and the Fund. As mentioned in the Managing Director's memorandum of the past month, the authorities had indicated their willingness to cooperate with the Fund and had already sent statistical material, together with a technical team, to initiate discussions with the Fund in preparation for a staff visit to Peru. That visit was a significant step in improving Peru's relationship not only with the Fund but also with the international financial community. Nevertheless, it should be emphasized that the Article IV consultation with Peru would not be successful unless it was conducted in a spirit of full cooperation with the Fund staff mission while it was in Peru and unless it was concluded within a reasonable time. Resumption of Article IV consultations would improve Peru's multilateral relationships with other members, and it would allow the Fund to support Peru in the international financial community.

However, despite improvements in relationships with the Fund, Mr. Ayales continued, Peru's arrears to the Fund had continued to accumulate. In recent conversations with the authorities, management and staff had not been able to obtain a firm commitment on the settlement of Peru's obligations. Payment of charges could, at the very least, avoid further detrimental effects on all members. The authorities should be urged to promptly meet their financial obligations to the Fund. As it was important to review the overdue payments in the light of the information that would be available through the Article IV consultation, it was appropriate that both discussions should be held together, as stated in the proposed decision.

Ms. Bush made the following statement:

In the six-month review of Peru's overdue obligations to the Fund (EBM/87/27, 2/13/87), the Board had been sufficiently concerned about Peru's intentions regarding its overall relations with the Fund to ask the Managing Director for the report before it today. The arrears problem had been growing since September of 1985, but the continued delay in conducting Article IV and Article VIII consultations had raised broader questions that had prompted the Board to ask for a clarification from the authorities of their intentions to fulfill in a timely manner their obligations as a member of the Fund.

In the Managing Director's communication of February 27 to President Figueroa, he expressed hope that Peru would provide tangible evidence of its commitment to fulfill its obligations both with respect to its overdue financial obligations and with regard to the scheduling of an Article IV consultation.

The report before us today provides welcome evidence of the authorities' intention to conduct Article IV consultations, which are a fundamental obligation of Fund membership. However, it is important that the consultations be thorough, since it has been 28 months since the previous one. The Board should be brought up to date on economic developments in the Peruvian economy in the context of the Fund's overall surveillance responsibilities and also to evaluate Peruvian economic policies. There should be no unnecessary delays in completing the consultations and bringing a report to the Board, and the staff and the authorities should be urged to expedite the pace of the consultations. Holding the Board discussions prior to August would be reasonable, and an acceleration of the consultations would allow for that.

A serious omission in the report is tangible evidence of Peru's intentions to become fully current in its obligations to the Fund. The report says that the authorities have not been in a position to indicate when settlement of the overdue financial obligations would be made, and President Figueroa's latest message does not add anything to our knowledge about the authorities' intentions. Perhaps the most tangible evidence that we have is the absence of any substantial payment to the Fund since August of 1986. In the meantime, the overdue obligations have risen from SDR 211 million, at the time of the February Board meeting, to SDR 258 million.

Since the issue of arrears was not addressed in the authorities' response, the Board should request a statement in writing of the authorities' intentions concerning prompt and full payment of financial obligations to the Fund. In fact, the decision should contain more direct language, urging Peru to settle its arrears. The same language that was used in the February 13

decision could be employed. That language read, "The Fund regrets the continuing failure by Peru to fulfill its financial obligations to the Fund in the General Resources Account and again urges Peru to make full and prompt settlement of these obligations." It is still very important that we give this kind of message to the authorities.

In addition, paragraph 2 should be amended to read, "The Fund will review the matter of Peru's overdue financial obligations to the Fund not later than June 26, 1987, and will consider a status report from the Managing Director on the Article IV consultations at that time." In two months the Board should again review the matter, because in the report from the Managing Director, nothing positive was said with regard to the arrears. In the case of an ineligible member, the Board normally expects reviews to be held no more than six months apart, and to wait until September would mean a delay of seven months. It is essential that the Board closely observe the developments in Peru in light of its continued failure to make substantial payments to the Fund and in light of evidence that other creditors seem to be given preferential treatment over the Fund. In that connection, Peru has again been in arrears to the World Bank, and there is a possibility of the Bank suspending disbursements under outstanding loan commitments. I would welcome a status report on that question.

We continue to be concerned about the problem of identifying specific actions to be taken by the Fund once a member has been declared ineligible. Of course, we have had an extensive Board discussion on the issue. The Board came to the conclusion that some options should be kept in reserve in order to apply them later, if necessary. It is important that the Board study all possible measures to force a country to honor its obligation to the Fund including, for example, concerted efforts by members that have particularly close ties with the country in arrears. The country's Executive Director, as well as other members in the constituency, may have relatively good prospects for helping resolve problems in some cases. We have also supported the idea of systematic cooperation among the debtors, Fund management, donors, and creditors to work to resolve arrears problems. In the case of Peru, this was made more difficult because of the growing size of the arrears problem and the reluctance on the part of the authorities to address it. Nevertheless, all possibilities should be explored.

It is important that the Fund, the World Bank, and other multilateral institutions take into account that a country is in arrears to one of the institutions. In this light we also look forward to the paper that is being prepared on the question of provisioning. It is worth exploring all possibilities, even the sale of currencies of members in arrears and the assessment of penalty charges.

Finally, we hope that management and the Board will identify new ways to cope with this problem to the benefit of the Fund, the country in arrears, and the membership as a whole.

Mr. Lim stated that he welcomed the Managing Director's recent dialogue with the authorities and the positive steps toward holding the long overdue Article IV consultation. However, those actions fall short of meeting Peru's obligations to the Fund. The report offered no indication of when Peru's arrears to the Fund will be settled. No payments have been received from Peru since the previous time the matter was discussed in the Board. Moreover, the final sentence on the first page of the report suggested that the authorities were not even willing to consider the issue. Peru could well afford to discharge its overdue obligations to the Fund. Its failure to do so must be judged as a deliberate decision not to cooperate with the Fund.

As to the proposed decision, Mr. Lim said that he supported the amendments proposed by Ms. Bush. It would be helpful to have an interim discussion to monitor progress of the Article IV discussions and the status of Peru's arrears to the Fund.

Mr. Al-Assaf recalled that in its previous meeting on Peru, the Board requested that the authorities fulfill Peru's obligations as a Fund member by settling Peru's financial obligations to the Fund. The Board's request was not that the authorities should simply send data to the Fund in order to complete a stage of the Article IV consultation. Only when a country fulfilled or tried to fulfill its financial obligations to the Fund did an Article IV consultation become appropriate and meaningful.

Steps other than another routine review of the matter should be taken, Mr. Al-Assaf considered. The authorities' actions were not only costly to the membership of the Fund, but they also contributed to Peru's economic and financial isolation and difficulties. He, therefore, urged the authorities again to normalize all aspects of their relations with the Fund, not merely to hold Article IV consultations by mail.

As for the proposed decision, Mr. Al-Assaf said that he could go along with Ms. Bush's amendment concerning the change in the date for the review and a response in writing regarding the authorities' intentions on relations with the Fund.

Mr. Posthumus stated that in February he had noted that repayments by Peru of its obligations would mean that it would lose only 14 percent of its reserves as 1986 was a good year and 1987 was also expected to be a good year for Peru, repaying its obligations to the Fund would be even less difficult than it was in February. Yet if he had understood him well, Mr. Morales did not repeat what he said in February, which was that Peru would honor its obligations in particular to the Fund. In the cable by the Governor in February there was a statement reaffirming the firm determination of the Government to make all efforts necessary to reduce

overdue obligations to the Fund. In the latest cable he found no commitments of that sort, which was disconcerting because it was a step backward. In the decision that the Board took that day, it should add a paragraph of at least the same content as in the decision in February. He supported Ms. Bush's amendment.

Mrs. Ploix said that like other speakers, she welcomed the re-establishment of relations between Peru and the Fund, albeit delicate, through Article IV consultations. However, there must be some leeway provided, and she thus supported the proposed decision. The Board should be informed of the latest developments before September 14, in the event the Article IV consultation was compromised by unforeseen events. Like Mr. Posthumus and Ms. Bush, she thought that words might be added to the decision urging Peru to settle its obligations to the Fund.

Mr. Foot said that it was particularly encouraging that preparatory discussions had already started for the Article IV consultation and that fact should be reflected in the decision by adding at the end of paragraph 1 "and welcomed progress toward early Article IV and Article VIII consultations." However, he was in agreement with Ms. Bush and others that if the Board took a formal decision, the language of regretting the failure to fulfill obligations should be repeated in the decision as well.

Mr. Schneider remarked that the two issues being discussed had been the ones confronted by the Board in the previous discussion on Peru--namely, the arrears to the Fund and the hesitancy of the authorities to conduct an Article IV consultation. That arrangements that had been made recently to conduct the Article IV consultation was most welcome. In that light, he supported Mr. Foot's proposal to add that the Board was welcoming the authorities' willingness. As to the arrears, it was of concern that no payments had been received in the meantime. On the contrary, arrears had increased. Furthermore, the authorities had made no indication when they would become current with the Fund. Therefore, he also supported Ms. Bush's amendment.

Mr. Lundstrom said that like others, he viewed Peru's failure to settle its arrears to the Fund with great concern. It was unacceptable that the authorities were still not even indicating when a settlement of the overdue obligations could be expected, not least in view of the negative effects on other debtor countries. Among them were countries with more precarious reserve positions than Peru, which had to suffer the consequences of Peru's continued failure to become current with the Fund.

The steps taken toward an Article IV consultation were, of course, most welcome, Mr. Lundstrom added. A regular consultation was a prerequisite for an accurate assessment of Peru's economic situation and would make it possible to consider factors influencing Peru's ability to pay.

The proposed decision did not fully reflect the seriousness of the situation, Mr. Lundstrom considered, and he would therefore like to see it strengthened. He could support an amendment along the lines proposed by Ms. Bush and with the contents suggested by Mr. Foot. He had some preference for Ms. Bush's amendment, which should then be supplemented by a reference in paragraph 1 to the progress toward an early Article IV consultation.

Mr. Murakami stated that he was concerned about the continued failure of Peru to discharge its overdue obligations to the Fund. Once again, he urged the authorities to make full and prompt settlement of Peru's overdue obligations and to cooperate closely with the Fund. On the latter point, he welcomed the fact that, as a result of a series of meetings recently between the authorities and the management and the staff of the Fund, an expectation had emerged that the Article IV consultation was to take place soon.

Finally, with regard to the proposed decision, Mr. Murakami said that he supported the suggestions made by Ms. Bush, and had no difficulty in supporting the amendment proposed by Mr. Foot.

Mr. Salehkhrou said that he welcomed the information the Managing Director had provided from his discussions with the authorities and the communication from the President of the Central Reserve Bank of Peru. The resumption of Article IV consultation discussions, albeit in stages, was also welcome as it would provide the Fund with comprehensive information regarding the realities of the Peruvian situation. He hoped that that first step would lead to the eventual settlement of Peru's overdue financial obligations to the Fund and the normalization of that country's relationship with the Fund. He supported the draft decision as proposed by the staff.

Mr. McCormack noted that resumption of Article IV consultations with Peru should be regarded as a positive step toward normalization of relations with the Fund. However, the authorities' lack of indication that they would repay was of concern, and further discussion should be conducted on that issue as early as August. He expressed a preference for the amendment proposed by Mr. Foot.

Mr. Goos indicated that he preferred Mr. Foot's amendment for the reason that the resumption of Article IV consultations was a delicate process that could lead to the normalization of the relationship between Peru and the Fund. Therefore, the Board should not be too impatient and possibly produce a counterproductive reaction. Nevertheless, he could support the suggestion of Ms. Bush if the majority of the Board so desired.

Mr. Finaish supported the proposed decision as amended by Mr. Foot.

Mr. Di Mauro welcomed the reopening of the Article IV negotiations with the authorities, but the lack of specific evidence regarding the authorities' intention to repay overdue financial obligations was a cause

of concern. Therefore, he was in agreement with the proposal made by Ms. Bush to seek a clear statement from the authorities on their intentions and to use more direct language in the decision regarding the overdue obligations.

The staff representative from the Western Hemisphere Department noted that Peru's payments to the World Bank had not been settled. There was a delay of more than 75 days at the moment, which could trigger a World Bank mechanism for declaring a member overdue.

Mr. Morales said that the next meeting on Peru should be in connection with the discussions of the Article IV consultation. The Article IV consultation would provide a clearer assessment of the economic situation in Peru and a better perception would be had of the overall problem. Therefore, he was more comfortable with a meeting as close as possible to August or September if it was possible by that time to conduct the Board meeting on the Article IV consultation.

Mr. Salehkhoul and Mr. Ayales said that they supported the decision as amended by Mr. Foot.

The Chairman remarked that his open and cordial conversations with the Peruvian authorities and the prospect of furthering the normalization of relations with the Fund through an Article IV consultation were indeed welcome. However, the telex from the Governor of the Central Bank of Peru had been disappointing, as it had not mentioned the clearance of the arrears to the Fund. Payment of Peru's overdue obligations to the Fund should be seen as a key element of the authorities' economic and financial policies, and he hoped that his next report to the Board would indicate a more positive attitude on the part of the authorities.

After a further brief discussion, the Executive Board then took the following decision:

1. The Fund notes the report from the Managing Director of April 27, 1987 concerning Peru's overdue financial obligations and relations with the Fund and welcomes the progress toward an early Article IV consultation with Peru.
2. The Fund regrets the continuing failure by Peru to fulfill its financial obligations to the Fund in the General Resources Account and again urges Peru to make full and prompt settlement of those obligations.
3. The Fund will review the matter of Peru's overdue financial obligations to the Fund not later than July 31, 1987 and will conduct the next Article IV consultation with Peru with a view to its conclusion not later than September 14, 1987.

Decision No. 8576-(87/65), adopted  
April 29, 1987



DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/64 (4/24/87) and EBM/87/65 (4/29/87).

3. APPROVAL OF MINUTES

- a. The minutes of Executive Board Meetings 86/131 through 86/133 are approved. (EBD/87/112, 4/20/87)

Adopted April 24, 1987

- b. The minutes of Executive Board Meetings 86/134 and 86/135 are approved. (EBD/87/115, 4/22/87)

Adopted April 28, 1987

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAP/87/90 (4/23/87) and by an Assistant to Executive Director as set forth in EBAP/87/92 (4/23/87) is approved.

5. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/87/95 (4/27/87) is approved.

APPROVED: November 12, 1987

LEO VAN HOUTVEN  
Secretary

