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Minutes of Executive Board Meeting 91/31

10:00 a.m., March 6, 1991

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	S. Gurumurthi, Temporary
	G. C. Noonan
	J. Gold, Temporary
	Zhang Z.
	M. E. Hansen, Temporary
	J. Prader
	G. H. Spencer
	B. Bossone, Temporary
	T. S. Allouba, Temporary
M. Fogelholm	
B. Goos	B. Esdar
J. E. Ismael	
	L. I. Jácome, Temporary
J.-P. Landau	J.-F. Cirelli
A. Mirakhor	O. Kabbaj
L. B. Monyake	L. J. Mwananshiku
D. Peretz	P. Wright
	G. P. J. Hogeweg
C. V. Santos	Y.-M. T. Koissy
	M. Galán, Temporary
	A. G. Zoccali
	M. Nakagawa, Temporary
	K. Ishikura, Temporary

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present

IBRD: T. P. Jones, E. Scanteie, Africa Regional Office. African Department: E. L. Bornemann, Deputy Director; P. A. Acquah, Z. Ebrahim-zadeh, M. T. Hadjimichael, P. L. C. Hilbers, I. Kapur, T. R. Rumbaugh, S. Sheybani, P. A. Youm. Exchange and Trade Relations Department: T. Leddy, Deputy Director; C. V. A. Collyns, M. E. Edo, B. Fritz-Krockow, L. Nielsen, P. J. P. Szymczak. Fiscal Affairs Department: S. K. Chand, J. A. Schiff. IMF Institute: B. Agbokuma, Participant. Legal Department: D. Asiedu-Akrofi, P. L. Francotte, J. L. Hagan, Jr., J. K. Oh. Secretary's Department: A. Tahari. Treasurer's Department: M. P. Blackwell, J. E. Blalock, W. J. Byrne, J. C. Corr, P. Fontana. Bureau of Statistics: E. O. Kumah. Office of the Managing Director: J. Grieco, Visiting Scholar. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, M. B. Chatah, C. D. Cuong, A. Gronn, Z. Iqbal, A. R. Ismael, J.-C. Obame, Y. Patel, B. Szombati, A. M. Tanase, N. Toé. Assistants to Executive Directors: G. Bindley-Taylor, B. A. Christiansen, N. A. Espenilla, Jr., A. Fanna, S. K. Fayyad, B. R. Fuleihan, O. A. Himani, C. J. Jarvis, M. E. F. Jones, P. Kapetanovic, K. Kpetigo, W. Laux, G. Lindsay-Nanton, J. Mafararikwa, J. K. Orleans-Lindsay, L. Rodriguez, S. Rouai, G. Serre, J.-P. Schoder, D. Sparkes, N. Sulaiman, S. von Stenglin.

1. REPORT BY MANAGING DIRECTOR

At Executive Board Seminar 91/3 (3/1/91), the Managing Director said that en route to Botswana, where he had attended the recent symposium of African Central Bank Governors, he had visited several African countries.

In South Africa, he had met with the Minister of Foreign Affairs and the Minister of Finance as well as with economic leaders of both the black and white communities to exchange views on the future role of a new post-apartheid South Africa in southern Africa, the Managing Director stated. While efforts to equalize social and living conditions of blacks and whites in South Africa posed a formidable challenge that would require intense cooperation with other countries in the region and support from the international community, the discussions had focused on the regional implications of a post-apartheid South Africa. Although South Africa would probably remain the major power in the region, it would face enormous investment and financing problems. Normalization of relations with neighboring countries would facilitate transportation and trade throughout the region and could lead to significant reductions in military spending. However, countries in southern Africa were concerned about the effects of possible negative developments, such as those arising from inflationary pressures in South Africa and limitations on the mobility of laborers migrating to South Africa from other countries. Those effects could be very significant for countries like Lesotho, where GNP was twice as large as GDP, owing to the income of citizens currently working in South Africa. The Fund would clearly need to take such factors into account in placing its surveillance of countries in southern Africa in an appropriate regional framework.

In Mozambique, he had met with political and economic leaders, who had conveyed to him their commitment at the highest level to pursue structural reform and economic adjustment under the enhanced structural adjustment arrangement, the Managing Director continued. He had also met with senior officials of the Roman Catholic Church, who had an important role in mediating negotiations between the Government and the rebels. In that connection, a partial cease-fire agreement covering the railway corridor to Zimbabwe had been finalized in December 1990. The Government was committed to achieving a comprehensive peace settlement as a major part of the economic recovery and development of the country. Significant progress had been made toward political reform in Mozambique. A new constitution, which had opened the way to a multiparty system, had been approved in November 1990, and general elections were scheduled to take place in 1992. While a peace agreement would lead to short-term economic problems, including the resettlement of a large displaced population, over the longer term many economic gains would be achieved, in particular by reducing military expenditures. While in Mozambique, he had meetings with ambassadors of the key donor countries to discuss the need for financing assurances, if possible, in the form of multiyear commitments, and the need to address

Mozambique's external debt problem in a more comprehensive way than hitherto.

In Zimbabwe, he had discussed with the authorities the newly published economic reform program, which was the result of three years of internal negotiations in Zimbabwe and was aimed at attracting foreign investment to create jobs for the growing number of unemployed school leavers, the Managing Director went on. In his discussions with the authorities, he had emphasized the importance of establishing a macroeconomic environment--including an appropriate investment code--that would be attractive to foreign investors.

In Zambia, he had met with the head of state and economic leaders as well as with representatives of donor countries, the Managing Director said. The authorities had reiterated their commitment to adhere strongly to the Fund-monitored economic adjustment program. In that connection, it should be noted that several administrative reforms had been implemented to improve the management of aid flows, and a committee had been formed to closely monitor progress under the economic adjustment program. He had stressed to the authorities the importance of maintaining timely payments to the Fund to ensure the recovery of Zambia's creditworthiness, in particular given the recent difficulties that had arisen as a result of the crisis in the Middle East.

Although Botswana had maintained on average a growth rate of about 10 percent per annum over the past ten years, the inflation rate was rising rapidly and the budget and current accounts were moving into deficit, the Managing Director noted. Therefore, the authorities were considering fiscal and monetary measures that would help to correct the current economic imbalance. They were also considering the implementation of structural adjustment measures aimed at creating jobs for the quickly growing work force.

During the symposium of African Central Bank Governors, he had attended frank and open discussions on structural adjustment, debt, and economic growth, the Managing Director concluded. The consensus among symposium participants was that growth-oriented adjustment, along the lines generally recommended by the Fund, was needed. Strong emphasis had also been placed on the need for the Fund to take a more active role in providing technical assistance to its members, particularly in the monetary and fiscal fields.

2. ZAÏRE - 1990 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINT UNDER RULE K-1

The Executive Directors considered the staff report for the 1990 Article IV consultation with Zaïre (SM/91/39, 2/20/91), and gave substantive consideration to the Managing Director's complaint under Rule K-1 relating to the overdue financial obligations of Zaïre in the General Department

(EBS/91/28, 3/1/91). They also had before them a paper presenting background information and recent statistical data on Zaïre (SM/91/47, 3/1/91).

The staff representative from the African Department stated that the staff had been informed that the Government of Zaïre had adopted on February 21, 1991, a stabilization program with its social partners. The program stressed expenditure control to keep to the budget targets for 1991, and provided for measures in the areas of exchange rate management, monetary policy, public enterprise pricing, and incomes policies. Among the most important measures to be implemented would be the progressive unification of the official and parallel exchange markets and the introduction of foreign exchange bureaus. Treasury bill sales at market-related interest rates, as a means of deficit financing and reserve money management, were also envisaged.

In addition, the staff had information indicating that the fiscal deficit for 1990 had been considerably larger--at about Z 413 billion, instead of Z 185 billion--than reported in the staff report, with the increase having been recorded mostly in December 1990, the staff representative from the African Department said.

The staff representative from the Treasurer's Department stated that Zaïre had made a payment to the Fund of SDR 9.4 million on March 4, 1991, which was not reflected in the staff paper. An additional obligation had also fallen due since the paper was issued. Taking those two factors into account, Zaïre's arrears to the Fund currently stood at SDR 23.5 million, with the oldest overdue obligations dating from December 4, 1990. With the most recent payment, Zaïre had made a total of SDR 17.7 million in payments to the Fund since the complaint was issued.

Mr. Santos made the following statement:

> The Zaïrian authorities wish to express their appreciation to the staff for the constructive discussions held in Kinshasa, and for the excellent work performed in connection with the 1990 Article IV consultation and that is reflected in the documents prepared for today's discussions.
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> As Directors are aware, the Zaïrian authorities' efforts to come to grips with the country's fundamental economic and financial difficulties led to the adoption of a comprehensive adjustment program for 1989/90 which was supported by the Fund with a stand-by arrangement and the second annual arrangement under the structural adjustment facility. As Directors would recall, the primary aim was to stabilize the economy in order to create an environment conducive to the restoration of public confidence in economic policies and the promotion of increased participation of the private sector in economic activity. Under

this program, some positive results were achieved. Inflation was brought under control, the rapid erosion in the value of the zaïre was arrested, and the foreign assets position of the central bank showed an improvement. Unfortunately, these gains were short-lived, as the adjustment efforts could not be sustained and reinforced when necessary to respond to adverse developments in the economy. In the event, the overall environment deteriorated sharply, and uncertainties settled in, fueled by high inflation and a rapidly depreciating domestic currency. As underscored by the staff in its report, with the emergence of mounting pressures for full democratization and a multiparty system, social tensions began to manifest themselves openly, including strikes and labor action. These populist demands were associated with large wage demands, which the authorities could not completely ignore; hence the pressures put on the resources of the central government, thereby exacerbating the existing uncertainties. These developments were further aggravated by the events in the Persian Gulf.

Under these circumstances, it is not surprising that Zaïre's internal and external financial imbalances worsened substantially in 1990, with aggregate output stagnating and further difficulties being experienced in servicing its external financial obligations, including those to the Fund. The stagnation of output reflected reduced responsiveness of the economy to incentives and the interruption of the operations in one of the major copper mines at Kamoto caused by an accident and labor unrest. The fiscal performance in 1990 reflects the difficulties that my authorities encountered in their attempt to balance the political and labor demands with the need to maintain fiscal prudence. They recognize that yielding to these demands is at the root of the increases in public expenditures in 1990. The monetary financing of the ensuing large deficit fueled the inflationary expectations, which became more pronounced, especially toward the end of 1990, thereby contributing to the pressures on the national currency.

Concerned about these developments and notwithstanding the uncertain political and social environment, the Zaïrian authorities recognized that they had to take urgent steps to reverse the deteriorating economic and financial situation. In this respect, the budget for 1991, which was presented to Parliament in December 1990, reflects this important objective of restoring control over public expenditures and using the central government budget as a foundation for future financial stability. It is important to note that this budget calls for a primary surplus of Z 546 billion, representing 4.8 percent of GDP, compared with a deficit of 4.5 percent of GDP in 1990.

On the revenue side, receipts are estimated to increase more than three-fold, from Z 561 billion to Z 2,167 billion. To meet this target, the authorities are strengthening their revenue mobilization effort, through a broadening of the tax base and through further improvements in customs and tax administration. A wide array of measures are being contemplated, including an upward revision of the minimum tax paid by certain individuals and enterprises, the introduction of exceptional taxes, and the revision in the price of petroleum products.

On the expenditure side, total nondebt expenditure appropriations have been limited to Z 1,620 billion, which implies that real spending in 1991 is being sharply reduced to the 1989 level. This cutback in real spending also implies that, with the need to reduce inflationary expectations, the monetary financing of the budget or the Treasury's borrowing requirements will be limited to about 18 percent of the stock of money at the beginning of 1991.

To help maintain firm control over public expenditure and ensure that inflationary pressures are subdued, the authorities are reinforcing the procedures for expenditure commitment and reviews. The control mechanism is now being operated on a weekly basis by a high-level committee. For 1991, the monthly operations of the Treasury will be based on a cash flow plan. Regarding other areas of public spending, the authorities intend to adhere to the strengthened budgetary procedures, with the overall aim of ensuring that expenditure overruns are avoided. The authorities wish to emphasize that underlying the expenditure control mechanisms that have been put in place is a clear commitment that should ensure not only their effectiveness, but should also forcefully impress upon the Zaïrian public that the central government budget is a sensitive tool for public resource management, as well as an anchor for financial stability.

In cognizance of the urgent need to place the spending pattern that emerged in 1990 in its proper perspective, particularly the wage and salary awards, the authorities signed on February 16, 1991 a social pact with a broad spectrum of social partners to secure a sound sociopolitical environment conducive to the resumption of the adjustment process.

The authorities are of the view that the steps envisaged in the fiscal area will lead to a strengthened financial position, in which monetary financing by the central bank will be scaled down. In this regard, ceilings on the central bank's advances to the Treasury are to be established and enforced, and the preferential interest rates charged on these advances are being revised upwards. The authorities intend to move toward financing the central government deficit through the issuance of Treasury notes that will be sold to authorized banks and the general public.

In the external sector, the authorities wish to reaffirm that their aim is to maintain a liberal trade and exchange regime in order to promote private confidence for increased economic activity. Thus, they intend to unify the official exchange and the parallel markets, and foreign exchange bureaus are being established to achieve this end. The foreign exchange budget for 1991 has been designed to contain the absorption of foreign resources by the government, and linking the central bank's sale of foreign exchange to commercial banks closely to the availability of resources.

Regarding Zaïre's overdue financial obligations to the Fund, the staff report presents a clear picture of the extreme foreign exchange constraints facing Zaïre, given the economy's reduced export earnings and foreign inflows of capital, as well as its large stock of external debt. However, the authorities have on many occasions stressed the high degree of priority they attach to settling their financial obligations to the Fund, as demonstrated by the large amount of repurchases (SDR 145.3 million) effected in 1990, against a virtual cut-off of foreign financial support. Moreover, in January and February 1991, payments totalling SDR 14.2 million were made, and over the past two days, a further payment of SDR 9.4 million was also made. The Zaïrian authorities would like to reiterate their commitment to discharge their overdue obligations and to resume normal relations with all the creditors, particularly the Fund. In this connection, the authorities are searching for ways to secure financing to enable them to settle their obligations. To this end, they have designed a complementary foreign exchange budget for the central bank that would provide regular payments to the Fund.

Finally, the Zaïrian authorities wish to assure the Executive Board that they are not undaunted by the obstacles that have adversely affected the pace of their adjustment to economic and financial stability. They are aware of the difficult task ahead, and they expect that the international financial community will resume its support to enable Zaïre to pursue its adjustment efforts and alleviate the cost on the poorer segments of the population.

Mr. Prader made the following statement:

The first months of implementation of the program under the stand-by arrangement approved in mid-1989 were promising, as was manifested in a significant increase in government revenues, the pronounced decline in inflation (year-end to year-end), and the remarkable improvement in the reserve position of the central bank. Unfortunately, these first positive results evaporated quite rapidly in 1990. Total government revenues in relation to GDP for 1990 contracted to the same level as in the year before the program implementation, and the reserve position of the central bank declined considerably, despite the relatively favorable international environment.

While the events of the last 18 months demonstrate the ability of the Zaïrian economy to respond to sound policies, they also illustrate how difficult it is to achieve lasting results. As outlined in the staff report, the cyclical movement in the adjustment process has not been exceptional in the 1980s. However, this time the stop-and-go adjustment was not due to unfavorable external developments.

The main reason for the dramatic economic deterioration in 1990 was the relaxation of fiscal and income policies, which led to an unprecedented increase in public spending, a sharp acceleration of monetary growth, and an inflationary spiral. The successive wage adjustments boosted the government wage bill to 39 percent of fiscal receipts, compared with an average of 23 percent in the two previous years. As a result, according to the estimates in Table 2 of the staff report, the budgetary deficit--before payments on external debt--attained 4.5 percent of GNP.

The damage inflicted by this sudden relaxation in policies may have been understated in the preliminary data for 1990. For example, total government expenditures are estimated to have more than doubled in one year, and even this sharp deterioration may not reveal the true development of affairs.

As a result of production difficulties by GECAMINES, export earnings declined by $200 million in 1990. The fall in production was not accidental, but rather was due to inadequate use and maintenance of existing equipment.

In Table 4, the staff mentions that total imports declined by the same amount. Given the already low level of imports in relation to GDP, we wonder if these estimates reflect the magnitude of last year's imports. Was the reduction distributed evenly between the major categories of imported goods, or did it mainly affect imports of capital goods and equipment?

Our first conclusion concerning the developments in 1990 is that some of the preliminary data might still give a too optimistic starting point for the 1991 projections. We agree with the staff that the budget for 1991 and the outlook for the current account are not unambitious. Without strong political will, it might be difficult to achieve the improvements embodied in these projections.

Table 2 of the staff report assumes that GECAMINES' contribution to the budget will more than double in terms of percent of GDP. Is this estimate consistent with only a marginal increase in copper export volumes and the decline in copper export unit values for 1991, as indicated in Table 4? We also have some doubts about the assumption of sizable reductions in expenditures for goods and services, in terms of total receipts, which does not seem realistic in Zaïre's present circumstances. Finally, we also wonder if it is possible to further compress total food imports in 1991 without adding more pressure to inflation.

In the present circumstances, a strong macroeconomic stabilization policy is an absolute priority, and we welcome the new stabilization package about which the staff has informed us today. Such a policy will not only need sufficient political commitment, but can only succeed if the Zaïrian authorities proceed with some essential structural reforms to increase the efficiency of the economy in terms of its ability to respond to positive incentives.

One can only regret that a profound debate about this fundamental problem has not been initiated under present circumstances. Indeed, the longer these structural reforms are postponed, the higher will be the social and economic costs, and the less enduring will be the results obtained in the macroeconomic field.

On the issue of arrears to the Fund, we take note of the recent payments, and would urge the authorities to increase their efforts and discharge completely their overdue obligations.

Mr. Monyake made the following statement:

The Zaïrian economy is facing major difficulties, with the average rate of inflation estimated at 179 percent in 1991, a projected central government deficit equivalent to more than 22 percent of GDP, and a debt-service ratio of about 34 percent, even after assuming debt rescheduling. Added to this is the continued decline in per capita income in the face of a high rate of population increase, and sluggish output growth. The level of unemployment is also high in Zaïre.

A reversal of these unfavorable developments would obviously require the adoption of strong stabilization measures, with a major role assigned to fiscal consolidation. Specifically, efforts should be made to contain expenditure growth, while broadening the revenue base. Appropriate monetary policy should also be adopted to complement fiscal adjustments. The pace of fiscal and monetary stabilization will be crucial to determining the degree of success of exchange rate reform, which is also important for enhancing the performance of Zaïre's economy.

In a paper prepared for the seminar on structural adjustment, external debt and growth in Africa just held in Botswana, the Governor of the Bank of Zaïre noted that the authorities have attempted during the 1980s to implement reform in various areas of their economy, and that there were some encouraging results. The problem appears to be the difficulty in sustaining the adjustment effort. The authorities seem to be aware of this, and have shown some intention to work toward improved economic management. I welcome this development, because the economy still has the potential to become more vibrant.

While pointing to the need for action on the domestic front, one should also note the serious external resource constraint facing Zaïre. Hopefully, a strengthened adjustment effort will encourage the donor community to augment flows of concessional resources to Zaïre and to grant appropriate debt relief.

It is reported that the authorities consider that a policy of weekly depreciations of the exchange rate succeeded in narrowing the spread between the official and parallel market rates to around 10 percent by the end of 1990. This does not appear to be very large, considering the tight external resource situation. It contrasts, for example, with the Ghanaian experience between 1983 and mid-1986 when, despite a series of discrete exchange rate adjustments, the cedi remained substantially overvalued, with the differential between the parallel and official market being about 100 percent. I would appreciate the staff's comment on what accounted for the more favorable situation in Zaïre, given the high rate of monetary expansion in the country. I welcome the latest information provided by the staff on exchange rate developments.

Mr. Esdar made the following statement:

Generally, in discussing a country's economic situation, it is good practice to begin by addressing positive developments. In the case of Zaïre, it is not easy to find such developments.

However, we appreciate the announcement of the new stabilization plan, and would like to hear some more details on it.

The staff's list of macroeconomic, as well as structural, slippages, and the massive loss of confidence by Zaïre's major creditors, illustrate the very serious situation, which is highlighted further by the following developments. Generally, since 1983, there was a stop-and-go policy, with often excessively high rates of monetary expansion and uncontrolled public spending, interrupted only for short periods by efforts at stabilization. In 1990, a continuing absence of expenditure control led to unprecedented increases in public spending, resulting to a large extent from massive civil service wage increases. An accommodating monetary policy has headed the economy into triple-digit inflation rates. The Zaïrian currency depreciated dramatically; spreads between official and free market rates widened. As a consequence of a massive loss of confidence, financial flows have been reduced significantly, leading to a widening external current account deficit and a lack of resources to finance necessary structural reforms. Generally, the economic environment for private sector activity has been eroded considerably.

There is no doubt that this economic situation requires a strong and fundamental reorientation of economic policies. The proposed budget for 1991 may be a first step in the right direction. However, in order to address the serious problems and the lack of confidence, there is an urgent need for a more comprehensive approach. In the fiscal area, as pointed out by the staff, there remain many inherent risks, especially from possible renewed wage concessions, as well as from uncertainties with respect to the contributions of GECAMINES. Therefore, more drastic cuts in expenditures and the possibility of increasing revenues should be explored further. In addition, it would be highly advisable to establish an institutional framework to keep wages, especially in the public sector, in line with economic possibilities. I have heard with much interest that there is some progress in this field. On the monetary side, the process of fighting inflation is crucial. Therefore, the central bank has to be committed to price stability, and its instruments should be strengthened. The objective has to be to establish positive real interest rates.

With respect to exchange rate stability, I am a bit surprised to see the staff's advice to rely on some exchange rate flexibility. In my view, following an appropriate devaluation of the currency, Zaïrian economic policy should be committed to exchange rate stability. Such a stabilization anchor would force the Zaïrian authorities to pursue a policy of domestic stability in order to avoid depreciation pressures and capital flight. External adjustment, should be no substitute for domestic stabilization.

I would like to stress that only a convincing reorientation toward a sustainable adjustment path, combined with a successful track record, will restore confidence in the Zaïrian economy. In this context, it is of utmost importance that Zaïre clears its arrears and regularizes its relations with its creditors. This is the only way to restore access to international financial support. I am, therefore, deeply disappointed that Zaïre's total overdue obligations to the Fund have increased further since January, but I take note of the recent payments. I can go along with the proposed decision.

Mr. Wright made the following statement:

Many Directors expressed reservations about the last stand-by arrangement for Zaïre when it was approved in 1989, and again expressed their concerns at the time of the first review. The staff report before us paints a very depressing picture of Zaïre's economy, which unfortunately bears out Directors' original doubts. We would perhaps do well to remember this and have the courage of our convictions when committing Fund resources in the future.

The key to the present economic situation is the extreme laxity of fiscal policy, with persistent expenditure overruns and extrabudgetary spending. This has always been the Achilles' heel of the Zaïrian economy, and repeated expressions of intent to do better in the future have not borne fruit. It is this failure, aided by an accommodating monetary policy, which has created rampant and increasing inflation and contributed to the chronic currency depreciation over a period during which the strength of copper prices offered a chance for real progress. There are, of course, particular pressures on spending, especially wages, at the moment, but these should be resisted, not least because they do not achieve anything, being swallowed up in the consequent surge in inflationary pressures.

As inflows of foreign exchange from donors and other sources have begun to dry up, and with no realistic prospect of debt rescheduling, Zaïre has already entered a vicious circle of deterioration. Unable to attract foreign funding, it will be unable to rehabilitate its infrastructure, as required if it is to continue to earn the foreign exchange it needs. Arrears to all creditors will then accumulate at an increasing rate. My impression from the staff report is that Zaïre has not yet quite passed the point of no return, but is perilously close to it. The economy could be turned around, but only with a massive and sustained effort of will on the authorities' part.

The current situation is particularly tragic because it is unnecessary. Zaïre is very generously endowed with natural wealth. If efficiently exploited and not squandered, this could be used to resolve current difficulties and form the base for development opportunities which have been wasted for so long. But this would require prompt remedial action, coming to grips first with the fundamental issue of fiscal correction. The staff report indicates the nature of the kind of fire-fighting exercise which will be required, and I generally endorse the staff's appraisal, including its skepticism about the generally rather implausible and inadequate 1991 budget plans indicated by the authorities.

Any meaningful attempt to deal with their difficulties will require the authorities quickly to make good their position with the Fund. I emphasize this because if there is to be any chance of Fund support in the future--and this would presumably be needed if the required debt reschedulings were to be forthcoming--then a considerable track record of cooperation would have to be established before such support could be contemplated. That track record would also have to incorporate very significant and sustained improvements in macroeconomic policy implementation. I would see an effective and independent system of expenditure control which really gets to grips with this previously intractable problem as a sine qua non for any future Fund involvement--this would apply equally to Fund endorsement of any adjustment program which did not involve financial support.

Concerning the Managing Director's complaint under Rule K-1 concerning Zaïre's arrears in the General Department, I welcome Zaïre's efforts to make payments to the Fund, but regret that these have not so far been sufficient to prevent a further increase in arrears since the Board discussion on February 1.

I can therefore support a formal limitation on Zaïre's use of general resources, in accordance with agreed procedures for deterring arrears. This will underline the Board's serious concern at the continued buildup of arrears, and encourage the authorities to implement policies that would reverse Zaïre's deteriorating economic situation before its arrears reach unmanageable levels and the Board is obliged to consider remedial measures. I am sure that the Managing Director will be reminding the authorities that the Fund stands ready to assist them in any appropriate way.

Mr. Cirelli made the following statement:

The staff has provided us with a very clear and frank assessment of the great difficulties the Zaïrian authorities are confronted with.

The overall picture is bleak and disappointing: last year's developments were characterized by a substantial worsening of the internal and external imbalances, which have been aggravated by an inappropriate response from the authorities. In addition, these disappointing results have had a regrettable consequence for the Fund: the buildup of arrears, which already represent more than 13 percent of the Zaïrian quota.

Looking briefly at developments in 1990, one certainly could regret that Zaïre has been unable to keep the stand-by arrangement with the Fund on track. Indeed, as mentioned in the staff report and in Mr. Santos's statement, the adjustment efforts initiated in 1989 had begun to prove beneficial. Unfortunately, they have not been sustained, and significant slippages have occurred. These slippages are extremely worrisome, given their size, and they need to be addressed promptly.

The importance of these macroeconomic imbalances, the acceleration of inflation, and the general uncertainty surrounding the economy could undermine the credibility of the authorities, and--at the least--should clearly show the need for urgent and forceful action.

I have no difficulty in endorsing the staff's recomendations. Obviously, tight internal financial policies are required if the authorities wish to regain control over economic developments. Above all, fiscal restraint should play a central role. In this regard, the objectives set in the 1991 budget go in the right direction and seem to be quite ambitious. The staff has rightly drawn the attention of the authorities to the risks and weaknesses attached to these objectives, in particular with respect to the revenue prospects and the transfers of GECAMINES. I can only urge them to stick firmly to these objectives, especially through reinforced expenditure controls, in order to ensure the credibility of their action.

One major source of the slippages has been last year's relaxed civil service wage policy. I would appreciate some comments from Mr. Santos or the staff on the content of the recent social pact signed on February 16, 1991.

An adequate monetary policy should complement the efforts contemplated on the fiscal front, and, in particular, a flexible interest rate policy is crucial to fight inflationary expectations.

A special effort should be directed to the maintenance of infrastructures and to the elimination of structural bottlenecks in order to safeguard the medium-term growth prospects.

As noted by the staff, the improvement of the situation in Zaïre will depend critically on the authorities' ability to demonstrate the credibility of their actions. The external accounts outlook is a source of great concern, and without a dramatic change in the current policies with a view to restoring the confidence of the international community, Zaïre is bound to enter a process of constant arrears buildup. Indeed, the size of the financing gaps for 1991 and the year ahead is quite daunting, and the prospects for closing these gaps appear uncertain and difficult without a strong commitment from the authorities to tackle the present imbalances.

In this respect, it is important that Zaïre make every effort to stay current with the multilateral institutions. Like previous speakers, I regret the increase in arrears vis-à-vis the Fund and urge the Zaïrian authorities to eliminate the present arrears as soon as possible. Meanwhile, I can go along with the proposed decision regarding the complaint issued under Rule K-1.

While endorsing the staff's appraisal, I would like to urge the authorities to take decisive action in order to tackle the present difficulties. I can go along with the proposed decisions.

Mrs. Hansen made the following statement:

We are in agreement with the staff's analysis of developments in Zaïre.

We are very concerned about the deterioration in economic conditions in Zaïre over the last year or so. It is very disappointing that despite a relatively rich resource base, the economy has performed so poorly; that such large imbalances have emerged; and that the situation has deteriorated to such an extent that Zaïre is unable to fulfill its financial obligations, even to the Fund. It is also saddening to note that despite Zaïre's considerable economic potential, real per capita GDP has declined for a number of years.

We welcome the assurances conveyed in Mr. Santos's statement that the authorities recognize the gravity of the situation facing Zaïre and are making an effort to improve fiscal management, limit credit expansion, and control inflation. However, given its past record, the Government will have to act promptly and forcefully to establish the credibility of these efforts. We hope that the adoption of the new stabilization program mentioned this morning will mark the beginning of a new chapter in domestic economic management.

The authorities seem to attribute most of their difficulties to labor unrest and the need to accommodate wage demands. The civil service is reportedly perceived to be underpaid. This points to the need for a civil service reform to reduce the number of employees on the government payroll and increase the average wage paid, rather than a generalized pay increase.

Obviously, the Government's ability to carry out such a reform depends in large part on the alternative employment opportunities in the private sector. A more dynamic private sector would also contribute to the easing of a number of other constraints, including the narrow tax base, and the diversification of export earnings. Yet without a dramatic decline in inflation and a less volatile exchange rate, the removal of price controls and other administrative controls, a better allocation of domestic resources toward the maintenance of basic infrastructure, and regularized relations with external creditors, it is difficult to see how the private sector can flourish.

The centerpiece of the stabilization effort must be control over the government budget, but we are skeptical about the realism of the 1991 budget for the multitude of reasons outlined in the staff report, and the staff representative from the African Department's report that the 1990 budget outturn was still worse than expected. With regard to the wage bill, in particular, the budget reportedly provides for a 35 percent general wage increase, implying a significant decline in real wages. In this regard, I would be interested in knowing what kind of agreements are included in the "social pact with a broad spectrum of social partners" referred to in Mr. Santos's statement. In particular, does this social pact involve understandings on real wage cuts?

In the external sector, it is no doubt true that Zaïre's immediate foreign exchange problems could be alleviated with a resumption of external assistance at previous levels. But it is difficult to make a case for renewed assistance, unless it can be shown that the resources will be managed appropriately. We hope that the authorities will demonstrate that this is the case in the coming months.

Turning to Zaïre's arrears to the Fund, we very much regret Zaïre's continuing failure to discharge its financial obligations to the Fund. This is contrary to the cooperative nature of the Fund, and places a financial burden on other members of the institution.

Currently, Zaïre's arrears to the Fund are relatively small, although as the staff representative from the Treasurer's Department noted, despite recent payments, they are growing. If the authorities are serious about adopting stronger policies and fulfilling their obligations, as they say they are, then we would expect these arrears to be cleared forthwith. In the meantime, we support the proposed draft decision to limit Zaïre's use of the Fund's general resources.

Mr. Nakagawa made the following statement:

The staff report gives us a clear description of Zaïre's economic performance, which deteriorated considerably in 1990. Both domestic and external disequilibria have widened in the past year and are projected to deteriorate further this year. In the medium term, a significant financing gap of the order of $700 million is projected each year between 1992 and 1994. External obligations falling due in the same period will be significantly larger than those of last year. Financial obligations to the Fund alone, for that period alone, amount to SDR 322 million. This chair has a serious concern about Zaïre's external viability during the coming years.

The cause of the rapid reversal of the modest progress toward economic stabilization that was witnessed in 1989 is well analyzed in the staff report. The staff appraisal rightly points out that the principal cause of the increasingly difficult situation has been the major relaxation of fiscal policy, due mainly to the excessive wage increase in the public sector. Uncontrolled public spending has been financed by large government borrowing from the domestic banking sector, which has led to monetary expansion. As a result, the consolidated overall cash balance of the public sector has deteriorated from a deficit of 7.5 percent of GDP in 1989 to a deficit of 13.4 percent of GDP in 1990. The end-year inflation rate has exploded from 56 percent at end-1989 to 265 percent at end-1990. This destabilizing domestic macroeconomic imbalance has been reflected in the rapid depreciation of the zaïre, which lost more than half of its value of the previous year. The current account deficit increased from 7.6 percent of GDP in 1989 to 8.4 percent of GDP in 1990. Regrettably, the authorities were not able to take advantage of the favorable developments in the copper price in recent years because of domestic production problems. Both domestic and external imbalances are projected to worsen further this year. Like previous speakers, I have a serious concern about Zaïre's external viability in the near future, and urge the staff to send a strong and clear message to the authorities so as to make them fully aware of the current economic situation--that they are now at a threshold and should take remedial measures as soon as possible, or face much longer and more painful economic adjustment in the future.

It is also regrettable that such a prolonged user of Fund resources as Zaïre is still unable to secure external viability and is facing major disequilibrium, both domestically and externally. I believe that the case of Zaïre provides a lesson for the staff in making Fund policy advice in relation to its development strategy. It would be worthwhile for the staff to review Zaïre's past economic performance in the context of the Fund's policy advice and try to draw some lessons from it.

With a view to safeguarding the Fund's resources, this chair can fully support the draft decision on the Managing Director's complaint under Rule K-1.

Mr. Noonan made the following statement:

The sharp deterioration in Zaïre's economic and financial situation, which occurred in 1990, is truly regrettable. The hard-won gains of 1989, which saw a turnaround in the public finances, a reduction in the inflation rate, and a remarkable improvement in the reserve position of the central bank, were reversed over the past year.

The principal reason for the worsening situation in Zaïre was a significant relaxation of fiscal and incomes policies. It is unfortunate that the Zaïrian authorities failed to show continuity and serious commitment to their adjustment and reform program. I observe that this relaxation of the fiscal stance was associated with mounting social and other pressures for political change. I do not find that a reassuring association. It implies that there cannot be political progress without a corresponding deterioration in the fiscal and incomes environment.

I fully agree with the staff that there is an urgent need for a front-loaded adjustment program, with expenditure reduction serving as the cornerstone for such a program. However, I am concerned that the budgetary outlook for 1991, from a realistic standpoint, may not, in fact, meet this need. On the expenditure side, it is to be noted that the full impact of the wage and salary increases granted in 1990 will cause a more than doubling of expenditures in 1991. I note from Mr. Santos's statement that the authorities, as recently as last February, signed "a social pact with a broad spectrum of social partners to secure a sound sociopolitical environment conducive to the resumption of the adjustment process." The staff confirmed the pact this morning. I would associate myself with Mrs. Hansen's questions as to what the pact means for wage and salary settlements in the current year. Does it entail a less than full indexation of wage settlements in 1991?

On the revenue side, I have observed that GECAMINES' contribution to the Central Government in 1991 is expected to increase from Z 100.1 billion to Z 750.2 billion, or by some 650 percent, at a time when copper export volumes are projected to increase by a mere 4 percent and copper prices are estimated to decline further, by some 12 percent. More disturbingly, according to Table 18 in the background paper on recent economic developments, GECAMINES' payments to the Government in the past have largely exceeded its surpluses, with an ever-increasing reliance on external financing to cover these shortfalls. A similar situation is likely to operate in 1991. Mr. Santos's statement refers to the several revenue mobilization efforts that are being "contemplated" by the authorities, as well as the various expenditure control mechanisms that have been introduced. The staff itself, however, points out the risks associated with the 1991 budget. Perhaps it would care to comment on the prospects for the attainment of a primary surplus projected at some 4.8 percent of GDP in 1991.

With regard to monetary policy, I note the very accommodating stance adopted by the authorities in 1990. I agree with the staff that monetary and credit conditions must be tightened if inflation is to be reduced and some measure of exchange rate stability attained. I am pleased to note from Mr. Santos's statement that it is the authorities' intention to issue treasury debt instruments to allow for the mobilization of nonmonetary financing to meet some of the Treasury's borrowing requirements. However, I cannot help but be disappointed that ceilings are only now being put in place and preferential interest rates revised upwards on central bank advances to the Treasury. In the circumstances, I concur with the staff that preferential low interest rates on central bank advances to the Government should be abolished, and that interest rates should be allowed to attain levels that are positive in real terms.

The urgency with which the Zaïrian authorities should proceed toward the implementation of tight fiscal and monetary policies is all the more important given the heavily indebted nature of the economy. The deterioration in Zaïre's external sector in 1990, largely owing to a decline in copper and coffee exports, as well as to a fall off in nonproject external aid disbursements on account of poor macroeconomic performance, placed the balance of payments under even greater pressure. In the circumstances, Zaïre's debt-servicing difficulties became even more acute. Indeed, it is very unfortunate that the benefits of the Paris Club rescheduling of 1989, as well as previous reschedulings, have not been able to serve Zaïre well, as evidenced by the buildup of arrears to the Paris Club, the London Club, the Fund, and other multilateral lenders. Moreover, this is all the more regrettable given that the 1989 rescheduling was based on Toronto terms.

I note that the Zaïrian authorities have, in principle, made sufficient provisions for repayment of their financial obligations to the Fund, but, in the light of experience, one must have some skepticism about this commitment. To rebuild credibility, I would urge the authorities to settle promptly overdue financial obligations and to honor, on a timely basis, forthcoming payments to the Fund as they fall due.

We share the distress and dismay of other Directors in seeing an economy such as Zaïre's, given its extraordinary potential, being managed in a way which has failed to establish the conditions essential to strong and viable growth. The Zaïrian authorities should continue the dialogue with the Fund staff, and I would add my voice to those of other chairs in urging them to implement fully, and as a matter of urgency, appropriate adjustment and reform measures in a sustained manner, so as to restore the confidence of the international financial community, as well as that of the private sector. The enormous untapped potential of the Zaïrian economy and the opportunity which this offers for the authorities to raise the living standards of the broad masses of the population, I believe, should not be wasted. I support the proposed decisions.

Mr. Fogelholm made the following statement:

The staff report on Zaïre is commendably concise and provides a frank and transparent analysis of the substantial problems and weaknesses in the Zaïrian economy. It is an excellent report that can well serve as a model for the treatment of program countries. I share most of the staff's recommendations.

It is, of course, most disturbing that Zaïre has once again fallen into arrears with the Fund, despite earlier assurances that appropriate adjustment polices would be pursued to prevent such an outcome. Driven by large public sector borrowing requirements--accommodated by monetary financing--the inflation rate has accelerated sharply and the deficits in the external accounts have once again increased to unsustainable levels, thereby negating Zaïre's ability to honor its debt-service obligations.

At the heart of the necessary adjustment lies an urgent need for fiscal consolidation. The authorities' recognition of this fact is indeed welcome, but the budget proposal for 1991--even though it is a clear improvement over last year's--still leaves much to be desired. Thus, not only is it imperative that real expenditures be cut further and procedures be introduced that are designed to restrain budgetary outlays, it is equally essential that measures be implemented to enhance revenues. In this connection, the Government's heavy reliance on contributions from a few enterprises is worrisome, not least for the implications this holds down the road for the financial soundness of these enterprises. The authorities should instead make a serious effort to broaden the tax base and include more frequent adjustments in the price of public goods and in fees.

Even if fully adhered to, the proposed budget implies a continuous buildup of arrears, despite the fact that it assumes a favorable rescheduling agreement with the Paris Club. Also, it is quite possible that the donor disbursements envisaged by the authorities will turn out to be overly optimistic, especially when one considers Zaïre's poor policy implementation and poor payments record.

Parallel to the necessary fiscal retrenchment must be a general tightening of monetary conditions--positive real interest rates should, as a minimum, be established as soon as possible, in particular.

The enormous economic problems facing Zaïre will require strong action on the part of the authorities. Admittedly, the current political situation does not make the task easy in the short run. However, the authorities have no choice--if they want to benefit from continued Fund support--but to act swiftly and begin immediately discussions with the staff on an adjustment program aimed at achieving medium-term viability.

In order for Zaïre to restore its credibility and to convince the international community of its resolve to act responsibly, the required policy measures in such a program should be mostly in the form of prior actions. Another prerequisite is, of course, the discharge of Zaïre's overdue financial obligations to the Fund, an issue that should be tackled decisively, and before it reaches unmanageable proportions.

I can go along with the proposed decisions.

Mr. Zhang made the following statement:

Zaïre's economic and financial situation deteriorated drastically in 1990. The annual end-of-period inflation rate surged from about 40 percent in May 1990 to 265 percent in December 1990. Because of declining export earnings, the external current account deficit increased to an estimated 8.4 percent of GDP in 1990, compared with 7.6 percent in 1989. I am in broad agreement with the staff's analysis of the country's economic development and its recommendations, and we found Mr. Santos's statement informative and helpful.

We can go along with the staff's appraisal that the principal cause of the increasingly difficult situation was a major relaxation in fiscal and incomes policies. Since April 1990, there have been three successive upward adjustments of wages, and the Government's wage bill has increased from the equivalent of 20 percent of fiscal receipts in 1989 to the equivalent of some 39 percent of fiscal receipts in 1990. Central government outlays (excluding debt service and externally financed expenditure) are estimated to have increased by some 126 percent in 1990, more than double the expenditure projection established in March 1990 by the staff in technical discussions with the authorities. The authorities are encouraged, therefore, to undertake strong measures to maintain a tight fiscal and monetary stance.

We note from the 1991 budget that the authorities have shown a strong determination to combat inflation through improving fiscal revenue and curtailing expenditure. However, it is generally recognized that only when the authorities keep a firm political commitment can the mechanisms for raising revenue and expenditure control--and the budget--function effectively. It is encouraging to note that a number of measures, such as a weekly review of expenditure commitments by a high-level committee and a new provision for prior spending authorizations by the Minister of Finance, have been adopted. However, in view of their vulnerable financial position, the authorities are encouraged to take further steps to tackle other problems in a timely fashion.

On the monetary front, it is of great importance that the accommodating stance of monetary policy be changed. It should be emphasized that appropriate and flexible monetary policy measures, particularly with respect to interest rates, be undertaken, and directed toward combating or resisting inflation.

With regard to Zaïre's external payments position, as export earnings are not expected to regain their 1988 level before 1994, due to production problems in the copper sector and a sharp decline of coffee prices, the balance of payments outlook and the central bank's foreign exchange position will continue to be very tight. Total export earnings have even been projected to decline further, by 6 percent in U.S. dollar terms. The external current account deficit would widen from 8 percent of GDP to over 12 percent of GDP in 1991. Therefore, the support and assistance of the international financial community, including the Fund, are indispensable.

We support the proposed decisions.

Mr. Hogeweg made the following statement:

I fully agree with the comments of earlier speakers. I am also gravely concerned about the new emergence of arrears to the Fund, and I specifically echo Mr. Fogelholm's remark on the importance of tackling the arrears problem at this relatively early stage.

It is most unfortunate that fiscal operations in 1990 have thrown the macroeconomic adjustment path completely off track. Many countries have some difficulty in exercising fiscal prudence in the face of elections, which is given as an explanatory factor, but the scale of derailment in Zaïre is daunting, and the country is in no way able to bear the consequences of such severe slippages. The problems go far deeper than upcoming elections. The staff rightly mentions deep-seated weaknesses in expenditure control, and stresses the political commitment necessary to do better--a commitment which in the past has not been shown consistently. Also, from a structural perspective, Zaïre is very vulnerable. The high dependence of the balance of payments, as well as the budget, on the copper company will have to be corrected. Like others, I wonder whether the 1991 budget is realistic, and, specifically, whether the projections for revenues are not overly optimistic. Such optimistic projections may be dangerous, since they can induce spending for which the funding may turn out not to be available.

I appreciate the section on exchange rate policy, which shows that distortions from the de facto dual market have added to Zaïre's problems. I fully agree with the need for adequate supportive interest rates and, more generally, tight financial policies, without which inflation cannot be overcome, and without which no exchange rate system will hold.

> The final sentence of the appraisal struck me. The staff recommends the standard 12-month cycle "in light of Zaïre's present economic difficulties." Does that qualification indicate anything about Zaïre's cycle in the future, and why? I am not aware that the recent conclusions of the surveillance review have reserved the standard 12-month cycle for countries with such serious difficulties as Zaïre. I fully agree with the proposed decisions, as drafted.

The staff representative from the African Department stated that a number of speakers had expressed misgivings about the realism of the budget. While expenditure control would be the key in improving the budgetary situation, improving revenue would also be important, and it was there that the staff had the greatest concerns about the forecasts. GECAMINES would be expected to contribute Z 750 billion to the budget in 1991, which far exceeded its expected surplus of Z 253 billion. The staff of the Fund, as well as of the World Bank, feared that GECAMINES might have to borrow to finance the central government budget, and in doing so, weaken its own position. Whether the forecast primary surplus of 4.8 percent of GDP would materialize depended on expenditure control, and the staff had no basis for assuming that the budgetary targets--and especially those on the expenditure side--would be maintained.

The social pact made explicit the need for the Government to get expenditure under control, and specified that the procedures which had already been discussed between the staff and the authorities would be implemented, the staff representative continued. There was an emphasis on a weekly review of spending--an important step in controlling expenditure. The pact generally summarized most of the policy guidelines that had been included in the policy framework paper approved in the context of the expired stand-by arrangement. It reiterated the need for price flexibility, restructuring the public enterprises, and the liberalization of the prices of public utilities, among other steps. It constituted the endorsement by the social partners of the policy guidelines that had been discussed with the authorities in the context of various Fund missions.

On the one hand, the documentation on the stabilization program did not include explicit language regarding incomes policy, the staff representative pointed out. On the other hand, the social pact did include language to the effect that wages would have to be adjusted frequently, especially the minimum wage, and that the Government should consider imposing rent controls and paying its arrears to medical personnel.

The recent import cuts had been concentrated largely on aid-related imports and some imports of GECAMINES, the staff representative noted.

A number of speakers had addressed the issue of the exchange rate policy, the staff representative recalled, and some had observed that the staff should perhaps have given some attention to exchange rate stability. Stability could only be achieved on the basis of sound macroeconomic policies, and in the present circumstances, the staff believed that the policy focus should not be diverted from the need for expenditure control and sound macroeconomic policies by attempting to fix the exchange rate. Moreover, it would be difficult for the Zaïrian authorities to put into effect a fixed exchange rate in the absence of adequate reserves.

The staff's latest information was that the official exchange rate for the zaïre was at about Z 3,350 per U.S. dollar, compared with a Z 2,000 per U.S. dollar at the end of December 1990, the staff representative related. The parallel rate, in contrast, was Z 4,000 per U.S. dollar. The spread, therefore, which had been reduced to 10 percent, was currently 19 percent.

The staff had not intended to suggest that annual consultations were to be restricted to countries with payments problems, the staff representative from the African Department concluded.

Mr. Santos stated that the present was a very difficult time for Zaïre, as it was for most of the countries in his constituency. Zaïre, however, was a very special case, because its longstanding cooperation with the Fund was in jeopardy because of the emergence of arrears. The means available to the country to address that serious problem were limited, for a number of reasons: first, as Mr. Wright had pointed out, because of the vicious circle that the authorities had put themselves in, through the existence of Fund arrears; second, because of the extreme constraints on external resources; third, because of the demands coming from the majority of the population for ways to correct social inequalities of the past; and fourth and very important, because of the uncertainties underlying the ongoing discussions on the constitutional framework that would rule the country in the future.

It was encouraging that Executive Directors recognized those difficulties, and that they welcomed the efforts that had been made by Zaïre in two key areas--the clearance of arrears, and the corrective policies that the authorities should put in place as soon as possible, Mr. Santos continued. On the issue of clearing arrears to the Fund, given the current circumstances and Zaïre's past performance, it was almost unnecessary to point out the strong commitment of the authorities to give the highest priority to payments to the Fund. The Board had witnessed a decrease of outstanding arrears recently, and the authorities were planning future regular payments to the Fund that would provide for further decreases, as the Governor of the Banque du Zaïre had indicated in his communication to the Managing Director. In that same communication, the Governor had indicated that negotiations were underway to secure a loan to settle the remaining arrears, and it was to be hoped, therefore, that at least by March or April 1991, a further decrease in the outstanding arrears to the Fund would be seen.

The stabilization package that had recently been adopted attempted to react to the staff's recommendations made during the Article IV consultations with Zaïre in November 1990, Mr. Santos went on. The package also reflected the understandings between the Government and the various social partners under the social pact, which should be considered--in the words of the social pact--as "an appropriate platform for ensuring macroeconomic equilibrium and guaranteeing purchasing power and social peace." Under the circumstances, it was understandable that, taking into account the imbalance between demands and resources, it would have been difficult to avoid a certain ambiguity in the document. The authorities' concern at that stage was to secure social tranquility in order to implement the package that was so needed for the stabilization of the economy. The main concern of the social partners, of course, was to improve social conditions. It was therefore evident that in the negotiations the social partners would try to secure from the Government some guarantees that purchasing power would not be eroded, and in that connection, there was clearly some pressure for some degree of wage indexation. However, also to preserve purchasing power, the document urged that the Government take appropriate steps to manage the economy better, to stabilize the currency, and to promote the growth of output. There was thus the perception that the basic way to avoid the erosion of workers' purchasing power was to stabilize the economy, and it appeared as if the social partners were willing to find the appropriate consensus to do it.

He wished to thank Executive Directors for their very balanced statements, and for their willingness to define ways and means that could help Zaïre out of its difficult situation, Mr. Santos concluded. On behalf of the Zaïrian authorities, he would also like to thank the staff for its cooperation and for the good advice it had provided to the authorities during the consultation discussions.

The Chairman commented that he could confirm the point Mr. Santos had made that the Governor of the Banque du Zaïre would take all appropriate steps to clear Zaïre's arrears to the Fund as soon as possible. The Governor was making efforts to find short-term financing to help Zaïre to clear the arrears even sooner than the normal flow of resources would allow.

The staff representative from the Exchange and Trade Relations Department stated that in Ghana--in contradistinction to Zaïre--the spread in the foreign exchange market was of the order of 30-50 percent before 1989. Since the unification of the markets in April 1990, the spread had been virtually eliminated; at present, it was 2 percent, and had been even less earlier in the year.

The Chairman made the following summing up:

> Executive Directors were in broad agreement with the views expressed in the staff appraisal for the 1990 Article IV consultation with Zaïre. They noted that the modest progress made

toward stabilization during the initial period of the 12 months covered by the program supported by the stand-by arrangement approved on June 9, 1989 had been quickly reversed, and that Zaïre's overall economic and financial situation had since deteriorated markedly. The external payments position had come under great pressure; Zaïre had been accumulating payments arrears to all creditors, including the Fund; inflation had surged; and the economy had been sliding into a spiral of strong wage-cost inflation and currency depreciation since the last quarter of 1990.

Directors observed with concern that the principal cause of the deterioration had been a major relaxation of fiscal and income policies, at a time of declining foreign exchange earnings. They pointed to the large pay awards that had been granted to the civil service and had been quickly generalized to the rest of the economy, as well as to the unrestrained public spending in other areas, which had led to a large monetary expansion and an accumulation of external payments arrears. As a result, recent data indicated that the fiscal deficit for 1990 had been considerably larger--at about Z 413 billion, instead of Z 285 billion--than reported in the staff report, with the increase being recorded mostly in December 1990. In the circumstances, Directors urged the authorities to implement without delay a front-loaded program of real public expenditure reduction as the centerpiece of a comprehensive stabilization effort designed to bring inflation under control and establish a viable basis for social and structural reforms.

Directors generally welcomed the adoption by the Government of Zaïre on February 23, 1991 of a stabilization program with its social partners. The program stressed expenditure cuts in real terms to keep to the budget targets for 1991 and to reduce substantially the public sector borrowing requirement. It also provided for measures in the area of exchange rate management, monetary policy, public enterprise pricing, and income policies. Among the most important measures to be implemented would be the progressive unification of the official and parallel exchange markets and the introduction of foreign exchange bureaus. Treasury bill sales at market-related interest rates, as a means for deficit financing and reserve money management, were also envisaged.

However, recalling Zaïre's previous record of inadequate expenditure control, Directors stressed that very strong political will would be required to implement the measures in a sustainable manner; to succeed, the authorities would need to adhere strictly to the budget and expenditure control procedures, particularly in the current period of strong political demands for large wage settlements and other public spending increases. Several speakers emphasized the importance of civil service reform and of a broader revenue mobilization effort.

Directors urged the early implementation of measures supportive of the needed fiscal adjustment. Such measures should include a tightening of credit conditions through sharp increases in interest rates; establishment of a transparent and realistic trading pattern in the interbank foreign exchange market; and significant adjustments in prices still subject to administrative control, to bring them to market-related levels. Directors were of the view that a credible adjustment effort was urgently needed not only to restore a measure of financial stability and growth, but also to encourage a resumption of external financial support to Zaïre. At the same time, it was essential for Zaïre to regularize its relations with all its creditors. In that context, Directors expressed regret that Zaïre had again fallen into arrears with the Fund. They noted the buildup of such arrears in recent weeks, but they also welcomed the payments which the Fund had received recently, and urged the authorities to settle promptly the remaining overdue payments and for Zaïre to stay current in its obligations to the Fund as they fell due.

It was expected that the next Article IV consultation with Zaïre would be held on the standard 12-month cycle.

The Executive Board approved the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Zaïre's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1990 Article XIV consultation with Zaïre, in the light of the 1990 Article IV consultation with Zaïre conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Zaïre's restrictions on the making of payments and transfers for current international transactions are maintained in accordance with Article XIV, except that the exchange restrictions evidenced by external payments arrears are subject to approval under Article VIII, Section 2(a), and that the multiple currency practice arising from the dual exchange market is subject to Fund approval under Article VIII, Sections 2(a) and 3.

3. The Fund encourages Zaïre to take appropriate steps to remove the restrictions subject to Fund approval and to apply liberally the remaining restrictions maintained under Article XIV.

Decision No. 9664-(91/31), adopted
March 6, 1991

Overdue Financial Obligations - Report and Complaint Under Rule K-1

1. On January 29, 1991, the Managing Director submitted a report and complaint to the Executive Board (EBS/91/12), under Rule K-1 of the Fund's Rules and Regulations, setting out the facts on the basis of which it appeared to him as of January 29, 1991 that Zaïre was not fulfilling its obligations under the Articles of Agreement. The complaint under Rule K-1 was that as of January 29, 1991, Zaïre was not fulfilling its obligations relating to repurchases and the payment of charges in the General Department in the total amount of SDR 29,167,657. These facts and the complaint under Rule K-1 were communicated to the authorities of Zaïre on February 11, 1991.

2. Having considered the report of the Managing Director, the complaint under Rule K-1, and the views of Zaïre, the Fund finds that Zaïre has failed to fulfill its obligations under the Articles of Agreement as stated in paragraph 1 above.

3. The Fund welcomes the payments made by Zaïre since the issuance of the complaint. Nevertheless, the Fund regrets the nonobservance by Zaïre of its financial obligations, urges Zaïre to give these obligations the highest priority and to resume their observance forthwith, and decides, pursuant to Rule K-2 of the Fund's Rules and Regulations, that Zaïre shall not make use of the general resources of the Fund until such time as Zaïre has become current in its obligations under the Articles of Agreement relating to repurchases and the payment of charges in the General Department.

4. The Fund shall review the matter of Zaïre's overdue financial obligations to the Fund within a period of three months from the date of this decision.

Decision No. 9665-(91/31), adopted
March 6, 1991

3. GHANA - 1990 ARTICLE IV CONSULTATION, AND REQUEST FOR THIRD ANNUAL ARRANGEMENT UNDER THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY

The Executive Directors considered the staff report for the 1990 Article IV consultation with Ghana and Ghana's request for the third annual arrangement under the enhanced structural adjustment facility (ESAF) (EBS/91/18, 2/11/91). They also had before them an economic and policy framework paper (EBD/91/22, 1/28/91) and a background paper and statistical appendix on Ghana (SM/91/43, 2/22/91).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on February 19, 1991.

Directors commended the Ghanaian authorities on their commitment to reform. Expressing support for the program's continuation, as outlined in the fourth policy framework paper, they welcomed Ghana's sustained effort in many areas, including structural reforms of financial and tax policy, civil service reform, and macroeconomic policy implementation. Several Directors supported the emphasis on promoting private sector development, as up to now it had not played a large enough role in the economic recovery program. One Director suggested that it would be an appropriate topic for the upcoming Consultative Group meeting.

Directors expressed concern about the deterioration in economic and financial performance in 1990, particularly the acceleration in inflation. They urged the Government to take the measures necessary to reduce price pressures, particularly through more effective implementation of monetary policy and the restoration of positive real interest rates. They noted that Ghana's balance of payments remained vulnerable to developments in world prices.

Directors commented on the need for speedier implementation of reforms in the area of state enterprises. Some Directors commented that up to now most of the companies under the divestment program had been liquidated instead of sold, and expressed concern that the slow pace of divestiture is sending the wrong signal to the private sector.

Directors urged the Government to implement the medium-term agricultural development strategy and highlighted the urgency of agricultural diversification and further work on food crops. They noted that higher agricultural productivity and growth would be critical to achieve the growth objectives of the program, as well as to alleviate poverty in the country.

Directors observed that the achievement of the growth target of about 5 percent per year depended on a strong private investment response to the new policy environment. They thought that the Government could best encourage the private sector by maintaining macroeconomic stability, particularly by reducing inflation, and by efforts to eliminate crowding out by the public sector. In addition, they emphasized that it was important that the private sector perceive a positive, open, and constructive attitude on the part of the Government. They welcomed other measures which the Government was taking to stimulate private investment such as tax reform and revisions in the legal and regulatory framework. They stressed that progress on both financial sector and state enterprise reforms would support the growth of private sector activity.

Some Directors commented that progress in implementing PAMSCAD continued to be slow. They supported the Government's strategy to incorporate poverty alleviation objectives into the public expenditure program. They urged that the Government take additional steps to incorporate social dimensions into its program.

Directors urged donors to support the program outlined in the policy framework program (PFP). They supported the goal of the program to reduce reliance on external concessional assistance, but recognized that donor support would continue to be necessary in the medium term.

The staff representative from the African Department stated that data just provided to the staff by the authorities indicated that key money market interest rates had risen by about 9 percentage points between September 1990 and February 1991, to reach 32-34 percent. During the same period, commercial bank maximum deposit rates had increased by 4-9 percentage points, to reach 22-29 percent. Maximum lending rates had risen by 6 percentage points, to 36 percent. At the same time, the latest consumer price index indicated somewhat faster than expected deceleration in the year-on-year national inflation rate, to below 36 percent for 1990. Moreover, preliminary data suggested a year-on-year inflation rate in January 1991 of about 32 percent. Thus, some interest rates had already reached positive levels in real terms, although further progress in that area would be necessary.

Mr. Mirakhor made the following statement:

The third annual arrangement under the ESAF marks an important watershed for the Ghanaian economy in its long and hard battle for economic recovery, stability, and sustainable growth. Coincidentally, March 6 marks the thirty-fourth anniversary of the date on which Ghana became the first country in sub-Saharan Africa to achieve independence. On this occasion, the country has every reason to feel a strong sense of achievement, in that the basic macroeconomic objectives of the economic recovery program (ERP) are largely realized. After an impressive and sustained seven-year effort to extricate itself from the brink of an almost total economic collapse, the Ghanaian economy is entering a phase of what one Executive Director called "economic trench warfare" of removing the remaining structural constraints and rigidities which tend to limit its ability to achieve self-sustaining growth.

Ghana is often cited as an important prototype of a developing economy in which an adjustment program was successfully implemented. While I have no intention of discussing here the replicability of the Ghanaian model, it is clear that Ghana's experience can be offered as evidence of the correctness of the Fund's decision in early 1980 to switch its approach from annual to medium-term adjustment. Moreover, this experience can also be cited as evidence of the appropriateness of the Fund's decision to be the first institution to move quickly and decisively to become involved in Ghana's recovery and adjustment efforts as the authorities were designing their economic recovery program. Finally, Ghana's experience is a vindication of the ESAF as one of the most important, useful, and successful facilities designed by the Fund to assist developing economies in their structural adjustment efforts.

The staff reports have detailed the progress made under Ghana's comprehensive and fast-moving reform agenda established by the ERP introduced in 1983 and designed to achieve a satisfactory and sustainable rate of growth consistent with external payments viability. Briefly, the objectives of the agenda included stabilization of the economy, rehabilitation of the infrastructure, and identification and removal of various structural rigidities and bottlenecks.

During the past seven years, most price and distribution controls were removed, economic incentives were extensively reoriented in favor of productive activities and exports through a progressive liberalization of the exchange and trade systems, as well as tariff reforms, and real producer prices for cocoa and other cash crops were increased substantially. Concurrently, suitable fiscal and monetary policies were implemented in order to reduce domestic and external imbalances. At the same time, the authorities were highly conscious of the social dimensions of their adjustment efforts as reflected in the substantial increase in government social welfare expenditure mentioned in SM/91/43 on page 38.

The results of all these measures were extensive and impressive. Real GDP grew by an average of 5.3 percent after a protracted period of decline, the inflation rate decreased from 120 percent in 1983 to an estimated 37 percent in 1990, and the overall balance of payments position turned into surplus after being substantially in deficit, despite the sharp deterioration in the terms of trade totaling 41 percent over the past four years. Similarly, domestic savings as a proportion of GDP grew gradually but imperturbably from an aver e of 3.5 percent in 1981-83 to an average of 8.8 percent, while investment grew an average of 3.6 percent to 15.2 percent over the same period. At the same time, import compression of the pre-ERP period was eased substantially, while the export diversification coefficient increased from 33 percent to 45 percent in constant prices. Gross official reserves rose substantially, external payments arrears were eliminated, the debt profile improved, and relations with creditors were normalized without Paris Club rescheduling. Concomitantly, institutional and financial reform measures were taken to strengthen the domestic banking system and divest state enterprises. In the case of the latter, after a slowdown particularly in 1989, when only 4 enterprises were divested, reforms were accelerated during 1990, when 23 state enterprises were either liquidated or divested, thus exceeding the program target of divesting 20 enterprises. In the case of the domestic banking system, plans for restructuring six of the seven financially distressed banks were approved, and implementation of these plans began in 1990. Meanwhile, government expenditures were increased substantially in order to permit the rehabilitation of the social and economic infrastructure. Perhaps the most striking success of the Ghanaian economic recovery program has been the unification of the exchange markets in April 1990, which has brought Ghana closer to full currency convertibility than most developing countries.

The Ghanaian authorities are fully cognizant of the fact that further efforts have to be made to consolidate the gains of the past seven years and achieve sustainable economic growth. To attain this objective, inflation must be controlled, incentives for private savings and investment significantly reinforced, and the role of the private sector substantially widened and strengthened.

The staff's background paper on inflation in Ghana identifies domestic food supply, petroleum prices, and monetary expansion as key factors that have most strongly influenced price developments in recent years. Of these factors, domestic food supplies have had the greatest influence, mainly because food prices constitute nearly half of the weight in the composition of the CPI. It is important to note that the food price index closely tracks the overall CPI, as seen in SM/91/45, Chart 1, page 4a, and the large swings in food production in turn have been strongly influenced by weather conditions. Major flooding in some parts of the country during 1989, and insufficient and delayed rainfall during 1990, resulted in stagnation of agricultural output, which, in turn, exerted upward pressure on food prices in 1989 and early 1990. The late rainfall in 1990 caused a shift in the seasonal pattern of food output, which was reflected in sharp increases in the rate of inflation in the third quarter and the reversal of this movement during the last quarter. To alleviate the vulnerability of the domestic food supply to changes in weather conditions, the Ghanaian authorities are committed to pay particular attention to the development of the agricultural sector in the context of a medium-term agricultural development strategy prepared in collaboration with the World Bank. Especially important is the objective of the expansion of food output through increasing the level and quality of agricultural support services, strengthening the input supply system, improving the incentive framework for agricultural production, and removing present weaknesses in management and storage of food supplies.

Petroleum product prices were raised substantially during 1983-90, as shown in SM/91/43, Table 6, on page 20, in an attempt to effect a full pass-through of the higher import costs, to strengthen government revenues, and to discourage cross-border informal trade in these products. In 1990 alone, prices of petroleum products were quadrupled, thus contributing substantially to inflationary pressures in that year--not only through the direct impact on the consumer price index, but also indirectly through increased costs of production and transportation.

It is important to note that, excluding the direct impact of petroleum, the order of magnitude of the consumer price index increase in 1990 is reduced to an estimated rate of 20 percent, as shown in SM/91/43, Table 7, on page 21. In view of the imminent introduction of a mechanism for flexible pricing of petroleum products, the lower world market price of crude should lead to a reduction in retail prices of petroleum products, with positive pass-through effects on the consumer price index. Any lower prices, however, would not lead to increased consumption, because the Ghanaian authorities feel that the price elasticity of petroleum products is not high enough to cause a large quantity response. Nonetheless, lower oil prices will imply an improvement in the terms of trade, with positive consequences for the balance of payments.

The Ghanaian authorities are keenly aware of the sensitivity of the medium-term balance of payments prospects to price developments of a few key commodities. In this connection, they intend to utilize all windfall savings accrued as a result of lower petroleum prices or higher than programmed cocoa prices for the building up of reserves, as underscored by the staff in EBS/91/18, Table 8, Appendix II, on pages 67-70. At the same time, appropriate actions will be taken to manage the liquidity implications of reserve accumulation in order to ensure that any increase in reserves will not undermine inflationary objectives.

With regard to monetary expansion, the staff has correctly indicated that the authorities have pursued a broadly restrictive credit policy during 1983-90. Despite this, the slowdown in monetary expansion was not sufficient to ameliorate the inflationary pressures arising from exogenous domestic supply shocks and cost-push factors. Beginning in the latter part of 1989 through 1990, however, the Bank of Ghana stepped up its efforts to absorb excess bank reserves, and strengthened its liquidity management capacity. As a result, broad money growth decelerated to a rate significantly below the prevailing rate of inflation. The Ghanaian authorities are committed to focus monetary and credit policies to achieve the targeted reduction in inflation to an average rate of 20 percent in 1991, and to 5 percent in 1993.

The Ghanaian authorities are fully aware of the difficult challenges that lie ahead in their attempts to remove the remaining impediments to achieving substantially higher levels of savings and investment, laying the foundation for a sustainable expansion in output. They are fully committed to correcting institutional factors, including the complexity and limited transparency of the legal and administrative framework and the weakness of the financial intermediation process. They are also keenly aware that unless these impediments to greater participation of the private sector in the savings and investment process are removed, the economy remains vulnerable to external shocks. It must be recognized, however, that the removal of deeply entrenched constraints takes considerable time and effort. While the authorities are firmly committed to do all that can be done, the order of magnitude of the increases in savings and investment required in the medium term still necessitates substantial long-term concessional assistance from donors.

The staff reports have detailed the authorities' attempts at privatization thus far and in the medium term; therefore, I will not enumerate them here. What is very important to recognize is that where there have been little or no deep-seated structural or institutional constraints, the authorities have moved decisively and with great agility in a number of areas to expand the role of the private sector in the Ghanaian economy. An example is the Government's actions to attract a private sector investment into the mining sector. In gold mining, for example, these actions are beginning to pay huge dividends. After more than five decades of virtually no exploration and more than two decades of steadily falling output, by October 1990, some 50 Ghanaian and 20 foreign companies had been granted either prospecting, exploration, or actual mining rights--figures which mining experts describe as unprecedented since the 1950s. Additionally, hundreds of small-scale miners and mining cooperatives have been given the go-ahead by the Mineral Commission to mine in areas where it is not feasible, either for economic or technical reasons, for larger companies to operate.

The upsurge in the private sector's involvement was due to the relatively strong economic stability and the confidence of investors augmented by incentive measures provided by the Government. These measures included an easy repatriation of profits and dividends, and a reduction of mining taxes. In the absence of institutional and structural constraints, the government action that was required was the revision of its own mining code, which was done quickly. In other sectors of the economy, existing rigidities make privatization and divestiture a much more complex, difficult, and time-consuming task. Moreover, forcing the pace of reform tends to bring about an accompanying tendency for these sectors to respond to reforms more slowly and with longer time lags than generally anticipated. Finally, shortages of skilled management and lack of access to long-term capital have compounded the problems of manufacturing and industry. Hence, the revival of activities in these sectors has been slower than expected.

Despite all these difficulties, the Ghanaian authorities are fully cognizant that much more needs to be done, and they are committed to do it. In a recent letter to the Managing Director, Chairman Rawlings assured the Fund that "for us in Ghana, there is no weakening of our resolve to pursue the path that we embarked upon several years ago to reverse a decade of decline in our national economy." Clearly, the Ghanaian authorities are unwavering in their resolve to carry through their commitment to economic, social, and political reforms for their country. They are, moreover, fully appreciative of Fund support for their reform efforts, as well as the support of the Fund for Ghana's reform efforts in the community of donors. The Ghanaian authorities fully intend to continue to have close consultations with the Fund and its staff as they implement their short- and medium-term economic program.

Mr. Peretz made the following statement:

You know the British fondness for tradition, so I am glad we can continue today what has become a rather good tradition, by commending the Ghanaian authorities on the steady progress they continue to make in restructuring their economy. All the quantitative, and most of the structural, targets were met over the last year. The foreign exchange markets were unified, external payments arrears were eliminated, the banking system was strengthened, and two dozen state enterprises were divested or liquidated. These and other reforms were completed against a background of somewhat disappointing output growth, but that largely reflected factors beyond the authorities' control.

The program for the coming year rightly gives priority to what I see as the main challenge facing the Ghanaian authorities: the need to intensify efforts to bear down on inflation. Part of the deterioration last year can be attributed to higher energy and food prices, but this cannot disguise the fact that inflation in Ghana has been stubbornly high for many years, and far higher than in some neighboring countries. There is a real risk that, if it is not tackled more aggressively, Ghana's achievements in recent years will be undermined by too fast inflation. I suspect that the authorities could learn something from the tough measures adopted, for example, by Nigeria to reduce its inflation from somewhat similar levels in 1989.

Above all, tackling inflation requires a tougher monetary policy. I welcome the authorities' commitment to make more explicit use of monetary targets, to continue net repayments to the banking sector, and to consult the Fund if liquidity expands more rapidly than programmed. But the key to effective monetary control and higher domestic savings is the authorities' willingness to raise and maintain interest rates at levels that are positive in real terms, and to react more promptly to adverse developments in the future. The staff representative's statement at the beginning of the meeting today is encouraging in this respect, but there may be scope for further Fund technical assistance in this area.

One particular issue is whether, now that the foreign exchange markets have been unified and liberalized, the authorities should make greater use of the exchange rate as a guide to domestic monetary policy. I do not want to get into a general debate of the relative merits of fixed and floating regimes. As you know, this chair's view is that different regimes are appropriate for different countries--although no country that is serious about containing and combatting inflation can afford to ignore the message from the exchange markets altogether.

In Ghana's case, exchange rate flexibility has greatly assisted adjustment to frequent and severe terms of trade shocks, facilitated convergence of the official and parallel exchange rates, and helped start to diversify the narrow export base. But, set against this, the steady depreciation of the currency over a long period has by now probably helped to entrench expectations that domestic inflationary pressures will continue to be accommodated. Therefore, I wonder whether the time may not now have come to give the exchange rate a greater weight in the operation of domestic monetary policy; or, possibly, to take the further step to try to improve inflationary expectations by moving to a system of fixed but adjustable exchange rates. In either case, of course, it would be more important than ever that the authorities demonstrate their willingness to tighten domestic policy by raising interest rates--and real interest rates--when and if required.

Alongside this tightening of financial policy, the authorities need to press ahead with structural reforms that would improve the supply-side response of the economy.

Priority should be given to further reforms in the banking sector, which was until recently the economy's weakest link. Despite the great strides that have been made to put the banking system on a sound basis by replacing nonperforming loans, there remains a lack of real competition, and this is reflected in the poor interest rates offered to depositors, cumbersome and costly procedures, wide spreads between lending and deposit rates, and a shrinking rural banking network. Meanwhile, households' high currency holdings suggest that the public's confidence in the banking system has not yet been fully restored. If the banking system is to play its proper role in transmitting monetary policy and mobilizing national savings, reforms will have to be deepened significantly. I therefore especially welcome the news that the World Bank is considering a second adjustment credit in this area. In particular, I hope that we will see much greater willingness to allow foreign and private sector participation in this area in the future.

This brings me to structural reform and the need to encourage the private sector and foreign investment generally. Seven years after Ghana embarked on its economic recovery program, progress in this area remains disappointing. Until a critical mass of private enterprise is firmly established, there will be no lasting growth in per capita incomes. A stable economic and political environment, a transparent and straightforward legal and administrative framework, a competitive banking system, and an improved infrastructure--particularly in agriculture--are all required to encourage the private sector.

However, it will be virtually impossible for private enterprise to flourish as long as inefficient state enterprises--of which few are profitable--are subsidized at the private sector's expense. State enterprises must be put onto a commercial footing and, as and when feasible, transferred to the private sector. This is a lengthy process even in an industrial country, but it is crucial that the momentum of divestiture, which was finally achieved last year, is maintained. However, it is worth noting that, so far, many more enterprises have been liquidated than sold as going concerns. That is probably inevitable in the early stages of privatization. It is the most inefficient businesses which are tackled first and later tend to be closed down. Obviously, liquidation was essential in many cases, but this does mean that only now is Ghana really embarking on the substantial phase of its divestiture program. Continued structural adjustment effort is likely to be needed in this area for some years to come.

I can endorse this program and the accompanying policy framework paper, which seems to be admirably well-focused. I can support, also, the modest augmentation of the access proposed by the staff which, in view of the various exogenous shocks Ghana has faced over the last year--shocks which have prevented an otherwise planned increase in reserves--and also the deepening of structural reforms, seems to be wholly appropriate. In particular, the shifting of foreign exchange surrender requirements from the Central Bank to commercial banks means it will be appropriate to establish a higher level of reserves than would otherwise have been the case. Even if there are no further adverse developments, therefore, I believe that the augmentation is needed to restore the reserves to a more comfortable level and underpin structural adjustment efforts.

As to the future, it is too early to say whether or not Ghana will be eligible for further Fund financing once this program expires. There are too many uncertainties in the months ahead. I feel sure that the authorities and donors will want there to be a continuing relationship of some kind between Ghana and the Fund, but it is not clear at present what form this relationship should take. Nor, I should say, do we need to take decisions on that now.

Let me commend the Ghanaian authorities on their performance over the last year.

Mr. Ismael made the following statement:

I am pleased to observe that the Ghanaian authorities have succeeded in sustaining the momentum of their macroeconomic and structural adjustments, despite some setbacks early last year, due in part to exogenous factors.

The improvements achieved thus far should provide a sound basis for the authorities to tackle the many problems that still persist, among these the relatively high inflation rate, and the need for further structural reform and a more active role of the private sector. I can support the proposed decision with regard to the 1990 consultation, and to strengthen Ghana's ongoing adjustment efforts I can also support Ghana's request for the third annual arrangement under the ESAF.

To stress the obvious, in order to reduce inflation, money supply growth must be slowed. Ghana's rate of inflation, although much reduced to 37 percent in 1990, remains high. The objective of reducing it further, to 10 percent in 1991, should therefore be welcomed. In this regard, I welcome the staff's statement on the recent increases in interest rates; nevertheless, it is important that all interest rates be restored to a positive real level as early as possible to lend credibility to the anti-inflation policy pursued; besides, it would support exchange rate policy and strengthen the mobilization of domestic savings. To achieve the targeted reduction in inflation, tight monetary policy should not only be maintained; it should be further tightened. I therefore welcome the measures that have been taken in late 1990 and early 1991 to reinforce the effectiveness of monetary policy.

Moreover, as the underlying cause of inflation in Ghana has been the high fiscal deficits--financed primarily through money creation--a reduction in the fiscal deficit, and thereby, in the growth of money supply, is obviously necessary. I therefore welcome the objective to lower the overall budget deficit further from 5.6 percent of GDP in 1990 to 4.4 percent in 1991. In addition, the broadly restrictive credit policy pursued during 1983-90 to slow monetary expansion, and the Bank of Ghana's strengthened liquidity management capacity, should be maintained.

A stable macroeconomic environment, although by itself conducive to a desirable private investment response, should be supplemented by structural reform. I welcome the intention to continue the bank restructuring program in 1991; restructuring of the banking sector is crucial to improving the mobilization of domestic savings and to stimulating productive investment. The planned tax reform and revisions in the legal and regulatory framework would add significantly to a transparent regulatory structure, which would further support the growth of private sector activity.

In the final analysis, however, growth of the private sector presumes the existence of a viable entrepreneurial class. I would therefore be interested to hear from the staff whether there is such a class in Ghana, and whether this entrepreneurial class is predominantly nonautochthonous; whether the fact that the state enterprises have been liquidated instead of sold, and the pace of divestiture has been slow, could not be explained in those terms, namely, that a viable entrepreneurial class, and one that is predominantly nonautochthonous, does not exist; and finally, whether specific measures have been introduced to foster the growth of a viable national entrepreneurial class and minimize possible social tension in the future.

The program before us embodies a set of appropriate objectives and measures. Given Ghana's good track record since 1983, I am confident that the 1991 program will be implemented with resolve and determination. However, the success of Ghana's reform efforts would be facilitated by the continued support of the international community.

Mr. Landau made the following statement:

The staff report makes it clear that the adjustment performance in Ghana has been successful in several respects, but that the progress already achieved needs to be consolidated. The developments that affected the second part of 1990 demonstrate again the necessity of implementing additional stabilization measures in a timely manner, when necessary. The main finding of the Ghanaian experience is, indeed, that any relaxation in the adjustment effort could lead to important difficulties, which more seriously undermine the gains already obtained. In this respect, I note that a rate of inflation of 37 percent remains unsustainable in the medium term, and reduced GDP growth in 1990--2.7 percent, instead of 4.8 percent foreseen in the program--also seems to indicate that the source of this slowdown could be more deep-seated than expected.

All things considered, and assuming that the 1991 budget is implemented rigorously, there are sufficient grounds for lowering inflation and for boosting structural reforms to reinforce the adjustment process. Like Mr. Mirakhor, I remain confident about the medium-term prospects of the economy, assuming that the Ghanaian authorities are able to overcome the remaining rigidities and impediments that affect the development of the private sector. I have no difficulties under these circumstances in supporting the increase in the access to ESAF resources. It is my understanding that this is not only linked with the rise of oil prices, but also with the need to strengthen the external position in a medium-term perspective. I welcome this demonstration of flexibility by the Fund, which I can only encourage in view of the needs of many ESAF-eligible countries.

Indeed, the Ghanaian experience could be considered as a successful implementation of the ESAF process. The difficulties that occurred recently demonstrate, however, the importance of maintaining tight budgetary and monetary policies at a time when the attention of the authorities should be devoted to deep structural reforms. I hope that the emergence of a dynamic domestic private sector will allow Ghana to graduate from the adjustment process and to ensure a sustainable economic growth rate in the future.

With respect to the macroeconomic framework, stabilization policies are still needed to address inflationary pressures. The staff background paper attributes inflation to a large extent to developments in agricultural production, but this is of course a partial explanation, as we have to look at the underlying macroeconomic factors involved. In this regard, a restrictive monetary policy is still of paramount importance to contain inflation, as well as an appropriate exchange rate policy. At the same time, it is undoubtedly imperative to remove current impediments to foodstuff production in order to reduce the dependence of the economy on exogenous factors. Resuming a strong economic growth path, with limited inflation, implies a reinforcing of food crop production and the streamlining of the distribution network.

On the fiscal side, major changes have affected the structure of both revenues and expenditures since 1983. Thanks to substantial concessional foreign financing over the period, the fiscal deficit, including grants, has declined, and net repayment to the banking system has increased substantially. However, the broad deficit, excluding grants, has widened, reaching 5.6 percent in 1990. These developments show that there is still a need to consolidate the fiscal structure. The movement which aims at allowing more reliance on domestic taxes, instead of on taxes on international trade, should be pursued, especially since the revenue to GDP ratio remains low compared with other African countries. Concerning expenditures, we commend the authorities for having streamlined current and capital outlays and for having expanded the coverage of social welfare needs, as well as infrastructure rebuilding. In this respect, it is worth noting that 50,000 civil servants have been redeployed since 1987 in an orderly manner. Finally, we are pleased to note that the objective of increasing national savings and investments has been reached. The next step will be to use the fiscal system to improve private savings in order to resume sustainable growth in due course. The 1991 budget contains--for the first time--sufficient incentives to reverse the previous trend by reducing the corporate tax and the capital gains tax. In addition, ensuring positive real interest rates, together with fiscal developments, should foster a tight liquidity position.

Concerning structural reforms, one cannot overemphasize the importance of building a favorable environment for the private sector. Establishing a proper business climate is henceforth crucial to address the present sluggishness of the economy.

Establishing a supportive private sector will depend mainly on the agricultural sector, and on creating a dynamic network of smallholder producers devoted to food crop production, as well as traditional export crops. In the same vein, local manufacturers should benefit from the measures included in the 1991 budget. Moreover, I agree with the staff on the necessity of significantly improving the economic information provided by the Government in order to facilitate decisionmaking.

In parallel, as underlined by Mr. Mirakhor, important progress has been registered in attracting foreign investors, particularly in the mining sector. However, reinforcing the local private sector should remain the top priority.

There is some scope for improving the overall situation as far as financial intermediation is concerned, in parallel with the current reform of the banking system and public sector restructuring. In this regard, my authorities are very aware of the necessity of creating specialized credit lines to the private sector, in accordance, however, with the ongoing streamlining of monetary policy toward market-oriented mechanisms. For this purpose, a credit arrangement of an amount of F 50 million will soon be set in place between the Bank of Ghana and France's Caisse Centrale de Cooperation Economique. In this regard, I support the orientation defined by the updated policy framework paper.

With respect to exchange rate policy, most, if not all, of the distortions in the exchange market have been removed, and the parallel rate has been eliminated, as shown clearly in the appendix--a welcome development. After a long period of continuous depreciation, perhaps the time has come for more exchange rate stability, and for a different exchange rate policy aimed at providing an anchor for stabilizing the inflationary process and inflationary expectations, especially since the inflation rate is still very high, at 37 percent; I totally agree with Mr. Peretz's remarks in this regard. The annex on exchange policy, which is technically remarkable, incorporates some policy recommendations, which deserve careful discussion and consideration. We do not agree with those policy recommendations. We think that they do not take account of a lot of factors which are involved in policy. I will not elaborate, because I will bore my colleagues with a new exchange rate discussion. We look forward to bilateral discussions on this matter with the staff. Nevertheless, we strongly support the proposed decision.

Mr. Ishikura made the following statement:

I join other Directors in commending the Ghanaian authorities' adjustment efforts over the past several years. The performance under the first- and second-year ESAF arrangements was broadly encouraging, as Mr. Mirakhor noted. Annual growth in real GDP, as well as real GDP per capita, has been maintained at a significantly higher level than in other sub-Saharan African countries. The overall balance of payments has registered a surplus since 1987. Gross international reserves have been increasing little by little, but steadily. Above all, it deserves special mention that the Government has consistently shown a determined attitude toward structural adjustment and has been continuing its far-reaching adjustment efforts with assistance from the Fund, the World Bank, and other multilateral and bilateral donors.

I generally support the staff appraisal regarding specific policies.

A reduction in the high rate of inflation is the most pressing issue to be tackled. The inflation rate of 37 percent in 1990 was considerably higher than the targeted level of 15 percent. This higher than projected inflation was mainly the result of the shortfall in food supplies and the oil price increase, but also partly of the delay in managing demand through monetary policies. Effective implementation of tight monetary policies will be imperative this year in order to sharply reduce the inflation to the targeted level, as Mr. Ismael noted. We welcome the authorities' efforts to strengthen liquidity management based on quarterly targets for broad money. Also commendable is the progress in absorbing excess liquidity through the net repayments by the Government to the banking system and sales of Bank of Ghana instruments to the nonbanking sector. The maintenance of positive real interest rates is essential to keep the downward trend of inflation. Furthermore, since the monetary front seems to be the key area for the program's success, the implementation of monetary policies by the Bank of Ghana should be strengthened to cope with the various monetary developments in an appropriate and timely manner. This being said, I am somewhat concerned that the budgeted increase in the wage bill of 26 percent in 1991 might prevent a sharp reduction in inflation.

Regarding structural policy implementation, we commend the greater than projected progress in many areas, particularly in the divestiture and reform of public enterprises. Moreover, we welcome the comprehensive reform of taxes on capital and investment income, which will serve as an incentive for private savings and investment. We expect the authorities to pursue their wide-ranging adjustment program according to schedule.

We can go along with the augmentation of access. However, the balance of payments outlook seems to be favorable for the coming years, unless there are adverse developments in export prices of cocoa and gold, or a large slippage in program implementation. In 1991, in particular, the external position is likely to turn out significantly better than the projection, which is based on the assumption that oil prices will be $29.20 per barrel for the first half of this year, and $24.60 for the second half.

Taking this into account, I would like to note that the higher cost of oil imports in 1991, which is the main justification for the augmentation, is estimated at SDR 50 million, calculated from these assumed prices. However, if the actual prevailing price of around $16 or $17 a barrel is used, what would the cost be? It is likely to be substantially lower than the original estimate. Also, in the second paragraph of page 28 of the staff paper, it is stated that in the event that oil prices turn out to be significantly lower than assumed under the program, the resources thus made available will be used to augment gross official reserves. Since the ESAF has no provision--unlike the CCFF--for early repurchase of any overcompensation, the expected excess amount purchased should surely be utilized to augment international reserves, and not wasted on imports of consumer goods. I am somewhat concerned about the negative effect of the import liberalization on international reserves. In this connection, we hope at least that the staff will take note of this matter, properly review the accumulation of international reserves, and report back to the Board at an appropriate time. With these considerations, we strongly hope that Ghana's external viability will significantly improve as a result of this third-year arrangement under the ESAF, including the augmentation, if approved. Also, we expect that Ghana will graduate from reliance on ESAF-type resources after successful completion of the third-year arrangement under the ESAF.

While sincerely commending the Ghanaian Government's efforts so far, we are watching the progress under the program, since we are strongly committed to the effective use of the limited ESAF resources. We should continue to consider carefully the content of the program and the appropriate amount of each arrangement under the ESAF in general, not just in this case. We support the proposed decision.

Mr. Koissy made the following statement:

Like previous speakers, I note that the economic and financial performance in Ghana weakened in 1990 after several years of impressive achievements. The rate of real output growth was nearly halved, inflation accelerated, and the external current account deficit, including official grants, widened substantially, with the ratio to GDP increasing threefold, although to a level smaller than programmed.

The fact that the impressive results of the past seven years could not be sustained, and that at a certain point a more modest pattern that could be sustained realistically would inevitably set in, should be borne in mind in assessing Ghana's economic performance. As explained in the staff report, a number of adverse exogenous factors--such as late and inadequate rainfall, disruptions in domestic food supply, and the sharp increases in oil prices on world markets following the onset of recent developments in the Middle East--have played a critical role. At the same time, it should be recognized that delays in devising and implementing some of the required corrective actions have also played their part.

The setbacks suffered in 1990 should not overshadow the Ghanaian authorities' commendable achievements, the most remarkable being the restoration of external payments viability by the end of this year. I welcome the acceleration of the structural reforms in 1990, as evidenced by the early unification of the exchange markets, the virtual elimination of all restrictions on payments and transfers for current international transactions, the successful completion of the first phase of the banking system reform, and the satisfactory implementation of the state enterprise divestiture program. I will not dwell on these, as they are well covered in Mr. Mirakhor's statement.

I agree with the staff that notwithstanding these remarkable achievements, the Ghanaian economy remains fragile and vulnerable to exogenous shocks, and that perseverance in the adjustment process is needed in order to consolidate these gains. I am reassured on this point by Mr. Mirakhor's statement that the authorities are fully cognizant of the need to sustain the adjustment efforts. I am encouraged by their unwavering commitment to address the remaining financial imbalances and structural weaknesses that are hampering the realization of the economy's full potential.

I can generally endorse the thrust of the program for 1991, as it lays appropriate emphasis on fighting inflation through a tightening of the fiscal, monetary, and credit policies and on deepening the structural reforms, particularly with regard to the exchange system and the state enterprises.

With respect to the inflation situation, during the last Board discussion on Ghana (EBM/90/87, 6/4/90), particular emphasis was put on the need to bring inflation under firm control, as it was then considered as the most important challenge facing the Ghanaian authorities. Several chairs expressed some doubts about the realism of the inflation target under the program, in view of the sharp upward adjustments in the price of petroleum products enacted at that time. Regrettably, these concerns turned out to be well founded, as the rate of inflation increased markedly, instead of receding. I note, however, that of the three main factors identified--the domestic food supply, petroleum prices, and monetary expansion--the first had an overwhelming impact on the outcome. This is not surprising, because, as explained by the staff and by Mr. Mirakhor, food prices have a large weight in the consumer price index--nearly one half. Therefore, developments in the consumer price index are very sensitive to movements in food prices, which in turn depend on domestic supply conditions. This raises the issue of the adequacy of the composition of the basket, and the respective weights given to the items. It should be mentioned that the basket used was calculated in 1977 and may not reflect current realities. I am therefore pleased to note from the background paper that the basket is under revision; but I am disturbed to read that food will command an even greater weight in the new basket. While some segments of the population presumably devote large portions of their incomes to buy food, this may not be the case for the relatively high income earners, and perhaps the city dwellers. Under these circumstances, one may wonder how relevant developments in the consumer price index are for macroeconomic management. I would appreciate staff comments on this.

Regarding the state enterprise reform program, I am pleased to note that after the marked slowdown in policy implementation in 1989, there was a reversal in 1990, with the program target being exceeded. I also note that for 1991, another 25 enterprises out of a list of 42 selected enterprises will be divested, including some in the gold and diamond mining sector. Given that concern has been voiced by some Executive Directors at the slow pace of divestiture, I would appreciate it if the staff could put the pace of the state enterprise reform in the proper perspective, by indicating the general progress made in this area since the initiation of the economic recovery program. I would also be grateful to the staff for further elaboration as to why, as stated in footnote 1 on page 26 of the staff report, no significant proceeds from the divestiture of the 25 selected enterprises will accrue to the budget in 1991.

Let me reiterate our admiration for the impressive results achieved by the Ghanaian authorities under their comprehensive adjustment program.

Mr. Al-Tuwaijri made the following statement:

I would like to join other speakers in complimenting the Ghanaian authorities on the commendable adjustment achieved over the past several years. However, the temporary slippages in 1990, despite steadfast progress over the past several years, reflect the fragility of the Ghanaian economy. They also highlight the recurring dilemma, in which performance criteria and structural benchmarks are met, but the underlying economic targets are missed by wide margins. While exogenous and unforeseen developments were certainly responsible for higher inflation and slower real economic growth, these slippages also reflect a somewhat weaker adjustment in financial policies.

As you may recall, during the midterm review in June 1990 (EBM/90/87, 6/4/90) it was emphasized that fiscal policy appeared to be overburdened and was being called upon to achieve potentially contradictory objectives. The easing of the budget stance to accommodate some of these objectives appears to have fueled inflation. Moreover, a flexible exchange rate policy, directed at securing a desired real effective exchange rate, and the continued negative real interest rates, appear to have had adverse effects. Similarly, the slower pace of structural reforms of the financial sector has probably weakened the ability of monetary policy to contain inflation. However, these observations in no way downplay the significance of steps taken to strengthen the program in late 1990. The program is now back on the adjustment path.

In view of the past performance, the new policy package, and the very useful information provided by Mr. Mirakhor in his statement, I have no hesitation in supporting the third-year arrangement under the ESAF, along with the requested augmentation of access. This additional financial support would not only compensate for the impact of higher oil prices, but also allow for the strengthening of official gross reserves which is necessary to support a speedy economic liberalization and a stable exchange rate.

I am in broad agreement with the staff appraisal and the policy content of the program. The achievement of the 1991-93 targets is rightly based upon a sharp reduction in inflation, a resolute expansion in domestic savings, and the establishment of sound mechanisms for transforming these savings into foreign exchange receipts. Moreover, there may have to be a stronger effort at reducing the savings-investment gap. The aim should be to further reduce reliance on external financing in the context of the evolving external environment. This will call for not only a continued tight financial policy stance, but also for accelerated structural adjustment aimed at a faster pace of privatization and enhancement of efficiency. In this context, the pace of the financial sector reform may have to be accelerated if financial intermediation is to be effective. Could the staff elaborate on the role of the planned entity in the private sector to restructure distressed corporations and banks? Is it realistic to expect such an entity to mobilize sufficient resources to handle the task?

With respect to the 1991 program, I am happy to note that there is a better assignment of policies to achieve the three underlying objectives than during 1990. The fiscal program is bold and should underpin a durable strengthening of economic conditions. It is to be expected that the redirection of expenditures and the rationalization of tax incentives would be fully adhered to. Needless to say, the authorities will have to be careful about ensuring that tax incentives do not lead to a weakening of the fiscal position.

A number of issues need to be addressed in the context of the current program. First, the balance of payments and inflation targets are based on an unrealistic oil price assumption. If lower prices were to prevail, leading to improved external accounts, care should be taken to avoid loosening the financial policy package. Instead, any windfalls should be directed toward investment and strengthening of the reserves position. While I note that the retail price of petroleum products would reflect world market prices, I am mystified by footnote 1 on page 16, which states that such pricing policies will be implemented with due regard to distributional, environmental, and other considerations. I would appreciate the staff's views on this statement in the light of the Board seminar on March 1, 1991, concerning the Fund's role in environmental issues (Seminar 91/3, 3/1/91).

Second, the enhanced role of monetary policy calls for not only a strengthening of the Bank of Ghana's ability to manage liquidity, but also an effective and early implementation of the Bank's restructuring reforms. While the substitution of nonperforming loans by Bank of Ghana bonds may have temporarily postponed the problem, the underlying weaknesses remain to be addressed. Banks, despite robust growth in the past, have been unable to locate bankable projects in the private sector. Underlying this dilemma are inefficiencies of the banking sector. That is why banks might have been unable to offer higher real rates of return to depositors. I am happy to learn that important progress has already been made toward establishing positive real interest rates. More progress is obviously required in this area. Could the staff provide some details on how the authorities intend to start addressing this dilemma in 1991 and the medium term? Needless to say, the area of bank restructuring must be pushed most forcefully.

Third, I am happy to note that the staff is proposing a greater degree of exchange rate stability. However, targeting a stable real effective exchange rate is not without risks, especially under circumstances of high inflation rates. It would be more helpful to target a relatively stable nominal exchange rate, which would call for a tighter reign on fiscal and monetary policies.

While Ghana has made good progress over the last several years and has effectively utilized the Fund's concessional resources, much remains to be done. Ghana epitomizes a number of other developing countries, which are likely to soon run out of access to such resources from the Fund. It is essential that the Fund aggressively pursue its catalytic role in mobilizing concessional funding and direct foreign investment for Ghana and other similar countries. This will help in promoting self-sustaining growth without an excessive external debt burden. I support the proposed decisions.

Mr. Spencer made the following statement:

This chair fully supports the third-year arrangement under the ESAF for Ghana. We agree with earlier speakers that Ghana's strong commitment to its medium-term economic recovery program, plus adequate financing provisions, warrant the continued strong support of the Fund.

The 10 percent augmentation might now look a little large in the context of current versus assumed levels of oil prices for 1991; but this may best be assessed at the time of the midterm review, in the light of outcomes for the whole range of external assumptions.

Since I am in general agreement with the staff's analysis and conclusions, the specific comments and questions that I have reflect secondary rather than major concerns. My comments relate to the two important areas of inflation control and the structure of economic incentives.

With respect to inflation and monetary policy, the analysis in the background paper on recent economic developments focuses on the three main determinants of inflation: food supply shocks, oil prices, and monetary growth. The analysis would have benefitted from a clearer distinction between short-run and long-run effects. For example, while seasonal variations in food supply clearly have a big impact on seasonal movements in the consumer price index, I remain to be convinced that this factor is a cause of the sustained high rate of inflation that we have seen in Ghana.

The inflation model might also have benefitted by including the feedback effects of domestic inflation on the exchange rate, particularly given that the nominal rate is being adjusted to maintain a roughly stable real exchange rate. As has been discussed in the Board on a number of occasions, such a policy can introduce a potentially destabilizing element into inflation dynamics. Even with a money growth target as a nominal anchor, if the real exchange rate target is set below its true equilibrium, then the authorities will have a very difficult time achieving their 5 percent inflation target. I would certainly agree with staff that additional monetary policy pressure will be required to achieve the target, but this may necessitate some increase in the real exchange rate, as well as the move toward positive real interest rates--the point made by Mr. Peretz and Mr. Landau. In the absence of any real appreciation, it is possible that the growth in net foreign assets may continue to offset reductions in domestic assets of the banking system, thus frustrating the broad money objectives. This situation can be likened to a driver trying to stop his car by applying the brakes, but without taking his foot off the accelerator. The car may well stop eventually, but there may be a lot of unnecessary wear and tear on the brake pads.

It is mentioned in the staff papers that there is need for improvement in the monetary control mechanism, but I am not sure if the staff sees the exchange rate policy as a potential problem here; perhaps it could clarify what it sees presently as the main constraints to an effective anti-inflationary monetary policy.

I am not sure the staff should be putting greater emphasis on the quarterly broad money targets, when the analysis in the background paper on recent economic developments suggests that there is a lot of noise in the quarterly numbers. In the empirical work, in fact, a three quarters moving average of money growth is used to help explain past inflation.

Many of the fiscal and structural policies included in the medium-term program are intended to promote savings and investment and, in particular, investment in agriculture and manufacturing. I have a general problem relating to the selective nature of many of the policy changes. When faced with a very distorted set of incentives to start with, it always seems safest to work toward a broadly neutral system, rather than trying to introduce new fiscal advantages for particular industries or activities. For example, I would certainly endorse the continued privatization of inefficient state enterprises, the public investment program aimed at developing the rural infrastructure, and indeed the moves to streamline labor laws and administrative procedures that have inhibited private investment in the past.

However, I do not see much merit in selective income tax reductions for particular industries, or in higher capital allowances just for manufacturing enterprises, for example. Similarly, while it makes sense to spread the overall tax burden and reduce the earlier overemphasis on export and import duties, I do not see the logic in reducing general income and sales taxes if it is at the expense of a massive increase in the petroleum excise tax. At the end of the day, the aim should be to remove biases in the existing fiscal structure, not introduce new ones.

On the particular policy objective of boosting savings and investment, the authorities and the staff need to be particularly cautious in their projections. The proposed tax changes will no doubt generate some increase in private savings and investment; but fiscal incentives always imply some offset by way of government dissaving, and, as many other governments have found, investors can be led to water, but they cannot be forced to drink.

Concerning agricultural incentives, the price smoothing and other benefits passed on to cocoa growers through the Ghanaian Cocoa Board and its monopsony on cocoa production have clearly contributed to the concentration of agricultural production in this particular crop. While the Cocoa Board structure might be contributing to overall export growth, it must surely be working against the Government's declared objective of export diversification. Also, of course, the compulsory acquisition policy offers no incentive for improved efficiencies in the distribution and marketing of this very important export commodity.

With respect to the incentives facing economic policymakers, if Ghana's economic strategy is to succeed in the long term, then it is important that the policymakers--and policy implementers--be held accountable for their actions; that is, the policies must be assessed in the country according to the results achieved. In order to facilitate this process, it is vitally important that the authorities make freely available the full range of economic data that is produced. Certainly, as earlier speakers have noted, the economic record over recent years can be seen as strong evidence of success to date in Ghana's economic recovery program.

I support the proposed decisions.

The staff representative from the African Department stated that a number of Directors had called attention to the question of the realism of the staff's oil price assumptions in the program and, in particular, to how current oil prices would influence the program. The program was negotiated in November/December 1990, at which time there had been no certainty that the price would be $18 a barrel. Therefore, the staff had agreed with the authorities that if the oil price turned out to be lower than that assumed in the program, the difference would go to reserves, and not to additional spending. If the current oil price of about $20 a barrel were maintained for the rest of the year, a windfall to Ghana, purely on account of the oil price, of about $60-70 million would result, raising gross reserves at end-1991 to the equivalent of about 4-4.1 months of imports, instead of the 3.6-3.7 that had been programmed, assuming that other factors remained the same. Of course, other factors had not remained the same. The cocoa price was different and the gold price slightly lower, and the dollar exchange rate vis-à-vis the major European currencies was also different.

The primary reason for the stance of external policies was to achieve a gross reserves target of between 3.5-4 months of import coverage, the staff representative pointed out. Such a cushion of reserves was necessary, in the staff's view, first, to enable the authorities to sustain the major structural change in the exchange system, the unification of the exchange markets in April, and the beginnings of an interbank market; second, to prepare for the major exchange reform which was to take place before the end of June 1991, under which a substantial shift from the central bank to the commercial banks of about $200-250 million of export earnings would take place; and third, given the advisability of protecting the central bank from the effects of the reforms with an adequate level of reserves, in view of the volatility of the prices of oil, cocoa, and gold.

Although a great deal of progress had been made in the state enterprise reform program between 1983 and 1990, it had not quite been up to initial expectations, and the staff would have liked faster progress in the preceding few years, the staff representative commented. However, the state enterprise reform program was in fact introduced only in 1987, with assistance from the World Bank. While a total of 38 state enterprises had been divested by the end of 1990, there remained 197 state enterprises at the end of 1990. Of the 38 enterprises that had been divested, 23 had been liquidated; 8 had been sold outright; some part of the Government's shares in four enterprises had been sold to the private sector; two enterprises had been leased on a long-term basis; and the management of one enterprise had been contracted out to the private sector.

The large share of liquidated enterprises testified to the fact that the authorities had begun the divestiture program with those enterprises that were difficult to sell to the private sector, as Mr. Peretz had observed, the staff representative confirmed. However, the staff had been assured by the authorities that the state enterprise reform program was back on track, as the evidence from the last half of 1990 seemed to prove, and that in fact it was to be reinforced under the 1991 program.

The proceeds from the divestiture in 1991 were likely to be insignificant because the state of the banking system in the previous few years had been such that obtaining medium- or long-term financing by private investors in order to purchase the state enterprises, or shares in them, had been very difficult, the staff representative explained; several Directors had noted the financial sector reform program. In the meantime, given the inability of those investors to raise medium-term financing from the banking system, the Government had allowed them to pay for their purchases of shares in state enterprises over a period of several years. The staff expected the income from the sale of those enterprises to pick up in the succeeding few years, but in the initial stages it would certainly be a modest amount. Another reason for the small income the Government would achieve was that the Government had decided that whatever proceeds there might be in the initial stages from the divestiture program would be deposited in a special account with the State Enterprise Commission--which oversaw the state enterprise reform program--to cover the costs very specifically of redeploying or indemnifying workers made redundant because of the liquidation of enterprises, as much for social and political as for economic reasons.

A great deal of emphasis had been placed on the need to raise private savings in the future, with which the staff agreed, the staff representative continued. With respect to the realism of the savings and investment targets over the succeeding few years, the staff was projecting an increase in private savings in constant prices during the program period 1991-93 of about 19 percent a year, which sounded like a great deal, until it was compared with the actual experience. Between 1986 and 1989, at the time when Ghana's terms of trade were deteriorating sharply, private savings grew by 29 percent a year in real terms. In the program period, the staff was projecting private investment growth in constant prices of about 15 percent a year. During the 1986-89 period, private investment had grown at 52 percent a year, although those were rates of change from a very low base in the mid-1980s. Nevertheless, those figures showed that while the staff's targets might be ambitious, they were not unrealistic.

There was indeed an entrepreneurial class in Ghana, and, in fact, the Ghanaians were noted in neighboring countries and throughout Africa for their entrepreneurial abilities, the staff representative remarked. The question remained, however, as to why, given the existence of those abilities, there had not been adequate private savings and investment in Ghana or an adequate development of the private sector over the previous few years, and how to bring it about in the future. The creation of a macroeconomic and structural environment in which all the incentives for private sector savings and investment were present was a necessary, but not a sufficient, condition for increasing private sector savings and investment. In the case of Ghana, it needed to be borne in mind that during the 20 years prior to the reform program, the entrepreneurial class had been, in a sense, almost completely destroyed. There had been a great deal of emigration at that time, and the general level of education had fallen. The effects of such developments could not be reversed in only three to five years, and in consequence, it might be some time before a real entrepreneurial class re-emerged in Ghana.

It was clear that the macroeconomic adjustment policies over the previous few years had been directed at creating the necessary conditions, and the staff believed that the authorities were aware not only of the need to create the necessary conditions, but also to do everything they could to encourage the private sector to invest, the staff representative continued. One senior Ghanaian official had once remarked when the mission raised that issue that the clearest sign that the development of the private sector in Ghana was on its way would be when it became acceptable to make money. Raising private sector savings and investment was an issue of the highest priority to the authorities; indeed, the Head of State had written to the Managing Director specifically about his intention to increase the Government's efforts in that regard.

There were several elements with respect to Ghana's exchange rate policies and the link with monetary policies, the staff representative observed. First, the staff was not recommending or proposing a nominal anchor for the cedi. Rather, when it had become clear during the period 1986-89 that the exchange rate was considerably out of line with the staff's best judgment of the fundamentals, the staff had proposed that exchange rate policy be directed more closely toward improving Ghana's competitive position, and that the real effective exchange rate might depreciate in relatively large amounts to the extent that such a depreciation was appropriate to securing competitiveness. One of the factors behind that judgment had been the very large differential between the parallel foreign exchange bureau exchange rate and the official rate--of the order of 40 percent or more two years previously. That differential had narrowed to 2.6 percent as of February 1991. As circumstances had changed, the staff was currently taking the position that the authorities should keep the real effective exchange rate broadly stable--implying making minimal changes in the nominal effective exchange rate--with the corollary that financial policies must be tightened to support the nominal effective exchange rate.

In the preceding year it would have been imprudent to think in terms of nominal anchors or of keeping the nominal effective exchange rate stable, at a time when inflation was very high, when there was a sizable spread between the two exchange rates, there were great uncertainties about the key prices for cocoa, gold and petroleum, and finally, when the level of reserves was low, the staff representative commented. At present, the real effective exchange rate had been flat over the preceding 12 months through February 1991. The nominal effective exchange rate, which had been depreciating by very large amounts--in the range of 30-40 percent a year for several years--has depreciated by only 10 percent in the preceding 12 months.

The staff had not been completely satisfied with the implementation of monetary policies in the past, the staff representative recalled, and in particular, with whether or not monetary policies would be effective enough to attain the targets that had been set in the program. Some of those doubts had proven to be correct. Under those circumstances, before the staff could rest easy that monetary policies would be able to play the role that they should play both in supporting the exchange rate and in taking over the role that fiscal policies had played in the 1987-88 period in bringing inflation down, the staff had wanted the authorities to make as much progress as possible in improving the financial system. Thus, the staff had focused on the reform of the financial sector and the appropriate phasing and linkages between monetary and fiscal policies, in order to build up the institutional capability of the central bank to implement monetary policy. That had included ensuring that an appropriate structure of interest rates was in place as a transmission mechanism for economic signals. The staff was currently satisfied that monetary policies had become more effective. By the time of the midterm review of the program, the staff would be in better position to judge whether the implementation of monetary policies was effective enough to enable the authorities to attain their exchange rate objectives for the year.

The footnote on environmental issues on page 16 of the staff report distilled the position of the authorities, namely, that they would take into consideration environmental issues in the determination of a whole host of policies, whether it was the private investment code, petroleum pricing policies, or taxation, the staff representative explained.

The staff could have done a much more detailed study on inflation, examining both short-term and medium-term effects, with a feedback to see the impact of inflation on exchange rate movements, the staff representative from the African Department concluded. A great deal needed to be done in those areas with respect to the staff's understanding of inflation. However, it needed to be borne in mind that the paper was the first instance of such a study in the case of Ghana, and that the quality of the data was not such as to allow research of the same kind that might be possible in industrial countries. The staff would continue to refine its conclusions in that respect. However, the importance to the program of the target for broad money should not be ignored. The experience in Ghana since the very beginning had been that the authorities had overperformed with respect to the balance of payments and net foreign assets, but they had been unable to sterilize the result. While domestic credit had been tight over the previous three or four years, broad money had grown at rates that were not compatible with a reduction in inflation. The staff was conscious of the fact that that should be interpreted with caution, and that policy conclusions must be carefully drawn. Nevertheless, the staff believed that it was extremely important that liquidity management policy be targeted toward the primary objective of reducing inflation, which could only be done by keeping a very close watch on broad money.

Mr. Goos made the following statement:

In general, I agree with the staff appraisal, and the rather high scores given by the staff and previous speakers to the authorities for the progress they have made in adjustment during the past few years. I should especially welcome the prospect that after implementing successfully the requested Fund arrangement, Ghana should be able to graduate from exceptional external financing, including, notably, financial assistance from the Fund.

However, much remains to be done. This is illustrated by the welcome comparative analysis in the staff report of Ghana's situation in relation to that of other African countries, which indicates that Ghana's economic and financial performance is lagging considerably behind developments in other countries of the region. It also becomes clear when the savings/investment balance in Ghana is compared not only with the situation of 1987, but also with the situation of 1983, as is shown in the table on page 11. Such a longer-term comparison suggests that the only significant improvement has been achieved in the investment ratio of the public sector--and even this improvement would appear to provide little cause for satisfaction against the background of the objective of strengthening the role of the private sector. The investment ratio of the private sector has remained flat, and the savings ratio of the private sector has declined significantly. In this regard, I found it particularly sobering to note from the report that after so many years of Fund involvement, the attitude of the Government toward private sector initiative is seen as still being ambivalent. Apparently the Head of State does not share this attitude, as indicated in the letter written to the Managing Director, but it is still a matter of concern, and might explain the slow progress in strengthening the private sector seen over recent years.

There is no doubt that Ghana's economic future lies in the first instance in the development of a dynamic and efficient private sector. Other areas of immediate concern--and here I agree with the staff and with previous speakers, especially Mr. Peretz--include the further acceleration of inflation and last year's deterioration in the external current accounts. There can, indeed, be little doubt about the crucial importance of significant progress in those areas for the viability of Ghana's economic and financial situation.

I am therefore glad to note that the program for this year is explicitly geared toward the problem areas I just mentioned. In general, it appears that the agreed measures go in the right direction. Strict implementation of the staff's recommendations concerning financial policies, including monetary management and interest rate policies, will be absolutely crucial, as will further progress in the area of structural reform. In this context, I welcome the information received this morning on the recent increase in interest rates, which I understand have become positive in real terms in some respects.

Nevertheless, and even recognizing that the recent acceleration in inflation is due to a considerable extent to special factors, I wonder whether the ambitious rate of growth of 4 percent of GDP in real terms which is envisaged for this year, as well as the ambitious growth rates seen for later years of 5.5 percent and 6 percent, are really compatible with the urgent need for rapid financial stabilization. I would therefore have thought it more appropriate if the authorities had compromised somewhat on their short-term growth target in the interest of achieving a significant reduction in the rate of inflation. Such a course of action would also appear to be advisable in view of the only marginal improvement in the GDP ratio for the current account envisaged for this year, which in fact would imply a further significant increase in the deficit in dollar terms, according to Table 3 of the report. We should not lose sight of the absolute dollar terms of deficits, because it is those amounts that need to be financed, and not the GDP ratio.

Moreover, I should like to stress that the stabilization effort ought to be supported by an appropriate incomes policy. In this regard, I wonder whether the key principles of incomes policy presently applied should not include explicitly Ghana's external competitiveness and the weakening in its terms of trade.

I should like to underline the importance of further significant progress in the divestiture of public enterprises--and here again I would like to associate myself with Mr. Peretz's observation--as well as the completion of the reform of the banking sector.

I feel encouraged by the ongoing effort at exchange reform, including the recognition of the benefits of stable nominal exchange rate developments and the intended abolition of the surrender requirements for the foreign exchange receipts from exports other than cocoa and gold. However, I would encourage the authorities to broaden the scope of this liberalization effort to include all foreign exchange earnings; and rather than relying on administrative means to enforce the surrender to domestic banks, this objective should be pursued more efficiently through appropriate financial policies, including the restoration of sufficiently attractive interest rates in real terms, with as little delay as possible.

In the context of the management capacity of the public sector, I received an interesting piece of information from my authorities indicating that much of Ghana's management capacity is being absorbed by the need to deal with numerous missions from bilateral and multilateral institutions. Thus, at the time of the visit of the Fund staff to Accra in early November 1990, the Ghanaian authorities had to discuss simultaneously new programs and economic measures with several structural adjustment missions of the World Bank, comprising more than 50 staff members, and at the same time they were engaged in bilateral negotiations with the German Government. I understand that this was not an exceptional situation. There are thus heavy demands placed on the Ghanaian authorities, and it is not surprising that they have only limited time left for reviewing and implementing adjustment measures.

Perhaps the problem of sometimes weak policy implementation could be significantly alleviated by improved coordination of donors and multilateral institutions. Moreover, it is to be hoped that the technical assistance that is to be provided by the Fund will thoroughly improve the situation. I can support the proposed decisions, and the proposed augmentation of the arrangement.

Mr. Mwananshiku made the following statement:

The impressive performance achieved so far under the ongoing adjustment program in Ghana has been made possible mainly by the authorities' continuing strong commitment to macroeconomic policies and structural reform. This performance is particularly noteworthy because of the substantive losses suffered by the country as a result of the deterioration of the terms of trade.

Despite the negative impact of such losses on the balance of payments current account, the country was able to achieve in 1990, after years of large deficits, a surplus in its overall balance, owing to an increase in net capital inflows. However, Ghana, like most sub-Saharan countries, has its productive base dependent mainly on primary products; its vulnerability to an adverse external environment, characterized by unfavorable terms of trade, may tend to jeopardize the adjustment efforts made by the authorities. In order to reduce the exposure of the economy to exogenous factors and weather uncertainties, parallel and vigorous efforts should be made to create and improve capacity in other sectors of the economy, so that they may contribute to the boosting of the overall production of the economy and sustain growth. This should be in addition to revitalizing the agricultural sector.

Although the performance criteria and benchmarks for 1990 were generally met, the high inflation rate--which substantially exceeded the targeted figure for 1990--remains a serious cause for concern. This has been partly attributed to intensified demand pressure in the economy. We therefore fully endorse the staff's view that monetary and fiscal policies should be further tightened. In particular, an appropriate credit policy should be used as an instrument to restrain growth in domestic liquidity. We welcome the authorities' initiative to control aggregate liquidity. The progress already made in the reform of the banking system and the commitment of the Government to proceed with additional restructuring measures are also worth noting. We encourage the authorities not to relent in their efforts to achieve improved banking performance and, through it, the efficiency of the financial system.

Although commendable efforts have been made by the authorities to improve performance in the fiscal area, further acceleration of the implementation of the state enterprise reform would help to reduce substantially its burden on the public finances. This would then assist the authorities in mitigating the social cost of adjustment, particularly on the most vulnerable groups of the population, and thus create an environment of acceptability and support for the needed adjustment reforms.

One of the striking features of Ghana's reform program was the success of its exchange rate policy that resulted in the unification of the exchange markets. The gradual approach adopted in this area, through a four-stage reform implemented over seven years, produced the desired result.

The strong commitment shown by the Government to the reform program deserves our full support and that of the donor community. Ghana needs financial support, particularly nondebt creating flows.

Fund assistance through the ESAF helped to support Ghana's adjustment effort without unduly burdening the country's repayment capacity. In this respect, we fully agree with the reference made in Mr. Mirakhor's statement that ESAF-type facilities are the most appropriate and useful ways of assisting the restructuring efforts of the developing countries.

We extend our best wishes to the authorities for the continued expansion of Ghana's economy for the welfare of its people. We support the proposed decisions.

Ms. Gold made the following statement:

Like other speakers, we would like to commend the authorities on their admirable record of performance since they embarked on the economic recovery program in 1983. This performance, in terms of growth per capita, reduction in domestic and external imbalances, and shifts in investment and saving ratios, is quite impressive and, I believe, unmatched by any of the other sub-Saharan African countries. I also wish to commend the staff on the excellent background papers. I found these very interesting and more helpful than the standard background paper on recent economic developments, and I hope to see more of such issue-oriented papers prepared for discussions of other countries.

As other speakers have noted, one of the key problems that continues to plague Ghana is inflation. Appendix I, which discusses inflation and its main determinants, shows that Ghana's inflation rate is very dependent on developments in agriculture. At the same time, it also suggests that monetary policy has accommodated the inflationary expectations that resulted from supply-side developments. We would urge the authorities to carefully adhere to the anti-inflationary strategy. As the staff indicates in its assessment, the achievement of this target is critical to the achievement of the other objectives of the program. However, we are concerned that current monetary conditions were not sufficiently tight, as real interest rates were expected to become positive only about midyear. We welcome the information provided by the staff representative from the African Department that interest rates have now increased significantly, but it is still unclear whether all interest rates are positive.

We are also concerned about the very limited pass-through of tighter monetary conditions to interest rates. The staff report notes that despite the large volume of open-market operations, money market interest rates rose only modestly until November 1990. The staff indicates that this is mainly the result of rigidities in the banking system, which is characterized by pervasive government controls. This suggests some failure on the part of the authorities to coordinate policies, because, given the pervasive government controls, the authorities should be able to ensure a better pass-through of tighter monetary policies to interest rates. Perhaps until there is substantial progress in implementing financial sector reforms, the use of more direct policy instruments could be more effective. I would appreciate staff comments on this.

Like Mr. Ishikura, we have some concerns about the augmentation of the program, which is based on an oil price assumption that is well above the current forecast. The problem of a changing oil price assumption has been raised during the discussions of a number of other countries. Nonetheless, I believe that in all the other cases, additional Fund resources were being made available through the oil facility of the CCFF. This facility provides for early repurchases in cases in which the actual balance of payments shortfall is more modest than expected, and thus provides some safeguard against forecasting errors. However, in this case, in which the balance of payments shortfall is being compensated by the augmentation of ESAF resources, there are no safeguards. Given the relatively modest augmentation, and the authorities' excellent record to date, we can go along with the proposed decision. Nonetheless, we would be interested in the staff's views on how best to safeguard the limited ESAF resources in similar cases. I note that the authorities plan to augment reserves by the gains resulting from lower than assumed oil prices. I would be interested in the planned increase in reserves should oil prices remain at their current level, and whether this increase will be viewed as a performance target, which provides some safeguards to the program.

The termination of Fund financial support after the conclusion of the third-year arrangement under the ESAF raises a number of interesting issues. As the staff illustrates, given continued generous support by donors and absence of major adverse exogenous developments, it seems that there is no balance of payments need which would warrant financial support from the Fund. In that regard, Ghana should be seen as a success, as one of the few countries that has been able to graduate from the Fund. However, as admirable as Ghana's success is, the country will continue to remain heavily dependent on donor support, and in this sense it is clear that Ghana has some way to go.

The fact that the Fund will no longer be financially active in the country could have implications for donor support. There are two concerns. First, donors may interpret the lack of Fund financial support as evidence that financial requirements have eased, and they could therefore respond by redirecting their assistance to other countries; and second, donors may become more reluctant to continue providing support of the same magnitude, as they could perceive conditionality to have been relaxed. The Fund, at both the management and staff levels, will have to ensure that neither of these reactions prevail. Rather, we hope that donors will view the cessation of Fund financial support as further evidence of the authorities' good performance to date, and that this will serve to increase confidence in the country and thereby lead to an increase in both official and private capital transfers.

I support the proposed decision.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/91/30 (3/1/91) and EBM/91/31 (3/6/91).

4. EQUATORIAL GUINEA - 1990 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1990 Article IV consultation with Equatorial Guinea to March 22, 1991. (EBD/91/4, Sup. 1, 3/4/91)

Decision No. 9666-(91/31), adopted
March 5, 1991

5. PORTUGAL - TECHNICAL ASSISTANCE

In response to a request from the Portuguese authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/91/52 (2/26/91).

Adopted March 1, 1991

6. ROMANIA - TECHNICAL ASSISTANCE

In response to a request from the Romanian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/51 (2/25/91).

Adopted March 1, 1991

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/91/45 (3/1/91) and by an Assistant to Executive Director as set forth in EBAP/91/42 (2/28/91) is approved.

APPROVED: October 29, 1991

LEO VAN HOUTVEN
Secretary