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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/94

3:00 p.m., July 19, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	M. E. F. Jones, Temporary
	Di W., Temporary
	C. S. Warner
	M. E. Hansen, Temporary
	J. Prader
E. T. El Kogali	L. B. Monyake
E. A. Evans	
E. V. Feldman	
	G. Montiel, Temporary
R. Filosa	
M. Finaish	
M. Fogelholm	
M. R. Ghasimi	
	B. Goos
J. E. Ismael	E. Kiriwat
B. Jalan	L. E. N. Fernando
A. Kafka	
	D. McCormack
	H. E. Codrington, Temporary
Mawakani Samba	
Y. A. Nimatallah	M. Al-Jasser, Temporary
	D. Marcel
	J.-L. Menda, Temporary
G. A. Posthumus	
K. Yamazaki	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
B. J. Owen, Assistant

1. Overdue Financial Obligations - Censure or Declaration of Noncooperation - Legal Aspects; Issue of Suspension of Membership; Six-Monthly Report and Review of Special Charges . . . . Page 3

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Adjustment Facility - Third Annual Arrangement . . . . Page 10

Also Present

IBRD: J. R. Damon, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; N. Abu-zobaa, S. E. Cronquist, J. Kakoza, E. M. Taha, A. B. Taylor. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; A. Basu, G. R. Kincaid. External Relations Department: S. W. Kane. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; J. W. Head, R. S. J. Martha. Middle Eastern Department: L. Alexander. Secretary's Department: C. Brachet, Deputy Secretary. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; M. P. Blackwell, J. E. Blalock, Z. Farhadian-Lorie, S. J. Fennell, D. Gupta, S. E. Nocera, D. V. Pritchett, P. S. Ross. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; P. Shome. Advisors to Executive Directors: N. Adachi, F. E. R. Alfiler, M. B. Chatah, W. N. Engert, M. Eran, A. Gronn, S. M. Hassan, J. M. Jones, P. O. Montórfano, F. A. Quirós, S. P. Shrestha, R. Wenzel. Assistants to Executive Directors: J. R. N. Almeida, B. A. Christiansen, M. A. Ghavam, J. Gold, S. Gurumurthi, A. Hashim, M. Hepp, R. Marino, A. Napky, W. K. Parmena, C. Schioppa, J.-P. Schoder, M. J. Shaffrey.

1. OVERDUE FINANCIAL OBLIGATIONS - CENSURE OR DECLARATION OF NONCOOPERATION - LEGAL ASPECTS; ISSUE OF SUSPENSION OF MEMBERSHIP; AND SIX-MONTHLY REPORT AND REVIEW OF SPECIAL CHARGES

The Executive Directors resumed from the previous meeting their consideration of a staff paper on the legal aspects of censure or declaration of noncooperation (EBS/89/128, 6/26/89), a staff paper on the issue of suspension of membership (SM/89/127, 6/28/89), and the six-monthly report on overdue financial obligations to the Fund (EBS/89/133, 6/29/89).

Mr. Posthumus said that he wished first to make two general observations. One was to note that the new procedures for dealing with overdue financial obligations to the Fund should command very wide support in the Board. Having listened to Directors' views, he was not certain that that was yet the case. Therefore, he ventured to suggest an approach into which the Fund's procedures would fit and which might help in obtaining wide support for the Fund's policies.

The objective must be to work toward a situation in which there would be no new arrears cases, Mr. Posthumus added. The existing six or eight cases should be the last ones. The collaborative operations that were being envisaged should be the last of their nature simply because in the future the Fund should not allow such cases to develop. Therefore, the issue should not be discussed as one of establishing a new procedure of some kind that would be used forever after, in a situation in which the Fund would have permanently to deal with cases of overdue obligations--other than technical overdues that might last only for a few weeks. The Fund was not setting up a policy for dealing with countries with payments problems. Nor should the Fund consider the issue of arrears as an element of the wider debt problem, as Mr. Jalan and Mr. Ismael seemed to indicate. The immediate issue was one of specific cases of arrears to the Fund.

What the Fund was trying to set up was a deterrence policy package, which by definition would never need to be used, Mr. Posthumus continued. The first part of the package was preventive in the sense that measures were taken both to help the member as well as to make clear that not paying the Fund was the wrong priority. The second part of the package gradually acquired a harder, even punitive content; otherwise the package would never have a deterrent character. The first part could be effective only if the second, punitive part existed, even if the measures themselves did not appear to be effective--in the sense that they did not lead immediately to payments by the debtor. To be an effective deterrent, the whole package of measures, or the full procedure, had to be spelled out clearly, without of course the expectation that it would be implemented but with a readiness to take even the final steps, after appropriate discussion in the Board. He felt sure that that general philosophy was supported in principle. Effective deterrence also required that, at the end of the road, the measures be punitive.

On the more technical issues, he considered that a declaration of noncooperation, by the cooperative institution that was the Fund, would be a very strong measure; it should of course be published and it would be expected to have a large impact. Again, its most important element might be that of deterrence. The declaration should be made by the Board. However, it should not indicate specifically when action toward compulsory withdrawal would follow. It would be sufficient to indicate that that action would follow because the Articles of Agreement made it possible.

As for the communications, it should be clear that the first letter to the governor was to help prevent arrears, and in it, the Managing Director might well ask that the content be conveyed to the head of state, Mr. Posthumus considered. The second letter should be written prior to the declaration of noncooperation and should be sent to all governors.

As for remedial measures, Mr. Posthumus added, it was clear that suspension was possible only after amendment of the Articles, which was not appropriate at present. However, should it become necessary on some future occasion to amend the Articles for other reasons, the issue of suspension could be taken up again because it seemed to be a better tool than compulsory withdrawal.

Finally, Mr. Posthumus recalled that his chair had on two occasions stated that the financial consequences for the Fund of its policies on overdue financial obligations should be looked into, and that an approach or procedure should be established for dealing with them if the need arose. He hoped that the staff would respond to that request.

Mr. Evans expressed his strong support for the general observations of Mr. Posthumus. Wide support in the Board for a particular approach, which was clearly needed on such a sensitive issue, did not appear to exist. But such support would, he believed, be forthcoming if the Board's approach was redirected along the lines suggested by Mr. Posthumus, namely, toward a long-term policy based on a philosophy of deterrence and consisting of a set of clear and clearly understood steps, and not primarily toward solutions of the problems of members currently in arrears.

Mr. Goos said that his views were very much in line with those of Mr. Posthumus and Mr. Evans. He recalled that he had mentioned the risk of conveying the wrong message to members if the steps to be taken in dealing with the issue of cooperation or noncooperation were formulated too loosely. Members needed to be aware of all possible subsequent steps, and whether they were likely to be affected by them.

He also supported Mr. Posthumus's suggestion that a clearer view was needed of the financial consequences of overdue obligations for the Fund, especially if the stage should be eventually reached at which compulsory withdrawal became an issue, Mr. Goos commented.

The Treasurer, commenting on the statement outlining the existing sequence of procedures and the way in which it would be implemented, said that it would be for decision on a case-by-case basis whether the first communication to governors, relatively soon after the emergence of arrears, would be sent to all governors or to a selected group only. In the Managing Director's statement prepared for the Board's discussion at EBM/89/27 (3/3/89), it had been proposed that the communication would be sent to all governors. Following that discussion, a more limited approach had been proposed in the Managing Director's report on overdue obligations to the Interim Committee, in the sense that it was intended that the letter be sent to a select group of governors, primarily those of the major creditors and donors to the country in arrears. The staff would reconsider the matter in the light of the discussion at the present meeting. What was important was that the Fund retain flexibility in the measures it applied in situations of newly emerging arrears.

In the same context, the Treasurer explained that the procedures described in the staff statement also included the first step, consisting of a cable to the authorities shortly after a maturing obligation to the Fund was not met, which urged the member to make full and prompt settlement. At that stage, delays in meeting financial obligations were frequently caused by administrative or technical difficulties, or by a temporary shortage of the necessary funds, and in the staff's experience most of those cases were settled within a reasonable period of time. However, if the staff's initial efforts failed to produce results, the Managing Director sent a cable to the governor urging the member to arrange immediate settlement. Those elements of the procedure were not new but had been followed in all cases of arrears since 1984, when the policy for dealing with arrears had first been developed. In the future, following the notice which was issued to the Executive Board one month after the emergence of arrears, the initial cable from the Managing Director to the member would include a statement that the Managing Director would consider consulting Executive Directors in an informal meeting about communicating with other governors, either all of them or a select group of governors. As he had mentioned, payments could be delayed for a variety of reasons, and the staff had not wished to restrict itself to a fixed period of time for sending the communications but rather to take into account the circumstances of each case, including in particular current contacts about the matter between the staff and the member concerned. As far as giving an early warning was concerned, he reiterated that the practice had been not to interpret the one-month notice period too rigidly to avoid alerting the Board unnecessarily to the emergence of arrears caused by temporary or technical factors, especially if the staff was in close and constant contact with the authorities of the member concerned.

The staff needed flexibility when forming its judgment whether a new arrears situation could be dealt with under the Fund's normal procedures or would require to be addressed in a more forceful way, the Treasurer added. Experience in recent months had shown that such flexibility had led to an improvement in the response of countries experiencing difficulties in making payments in a timely fashion.

As regards specific administrative arrangements designed to ensure that a country would settle its forthcoming obligations to the Fund on time, the Treasurer explained that it had been the practice for some time to make such arrangements in an effort to forestall the emergence of arrears because of the type of temporary difficulties he had mentioned. Those arrangements were basically threefold. First, member countries with a history of technical payments delays--for instance, because of the failure to provide instructions in time to effect the payment on the date the obligation fell due--had been asked to give the Fund standing orders to debit their SDR accounts for obligations to be discharged in SDRs. Second, member countries had been encouraged to maintain a certain balance in their SDR account so that the necessary funds were available when obligations fell due. There had been instances of countries having the means to make payments when the respective obligations were falling due but not holding sufficient amounts of SDRs in their SDR accounts to meet interest payments on net use of SDRs and charges payable in SDRs. Third, countries were invited to ask for the Fund's assistance in acquiring the necessary amounts of SDRs in sufficient time before an obligation fell due so that the SDR account could be debited. Those arrangements had in fact been mentioned in the Executive Board's report to the Interim Committee on the matter of overdue financial obligations of September 9, 1988.

Mr. Goos recalled that he had asked for clarification of when the Executive Board had agreed that the first letter to governors would be sent only after informal consultation with the Executive Board, and after the short period of six weeks, as stated in the footnote to the staff statement.

Mr. Nimatallah said that he had always considered that the first letter, which was sent at a very early stage when arrears first developed, should be left to the discretion of management, on a case-by-case basis. It was the second letter, which will be sent at a later stage to which he gave more weight.

The Acting Chairman noted that some progress had been made in the exchange of views that had taken place that day. Nevertheless, a number of Directors continued to have doubts that warranted giving the Board the opportunity and time for further reflection and discussion. Some specific requests and issues had been put to the staff, and he suggested that the staff should revise its opening statement, taking into account specific elements on which agreement had been achieved, and also addressing those issues on which views differed. The revised statement could then be discussed in about one week's time in order to provide the basis for the discussion on August 18. In that way, the momentum would be kept up, as a number of Directors wished, and some of the issues that had been raised could be addressed.

Two general issues required more reflection, the Acting Chairman went on. First, some Directors had asked whether the approach to arrears was consistent with the cooperative character of the Fund, whereas others had put the question in terms of the existence of the arrears problem itself being inconsistent with the collaborative character of the Fund. The second general issue was the dilemma of how to provide the Fund both with the flexibility to deal with changing circumstances and conditions, and at the same time define a clear set of guidelines and a well-understood sequence of steps, that nevertheless did not put the Fund in a rigid straitjacket. Again, there were differences in emphasis among Directors as to whether they wanted more flexibility or more explicit, clear-cut guidelines that would trigger certain actions. The right balance between the two approaches still had to be found.

On the specific issues raised in the staff statement, the Acting Chairman referred first to the question of whether the early communication should ask the Governor to bring the matter to the attention of his authorities, and to the second question of whether the Managing Director should communicate directly with the head of government of the member concerned. It was the general view, he believed, that it was the responsibility of the financial authorities--the Fund Governors--to report on the emergence and continued existence of arrears to the head of state, and that it might be redundant to ask explicitly in the communication that Governors should do so. While direct formal communication with the head of state would not be appropriate as a general rule, it was also understood that the Managing Director had on occasions communicated with the head of state and that he should not be precluded from doing so informally, at his discretion, depending on the relationship with the member and the head of state. Perhaps, as the procedures and guidelines were elaborated, it could be made more explicit that Governors were expected to bring the matter of arrears to the attention of their political authorities, and indeed to do so as soon as possible. Arrears to the Fund were an important matter that should not be hidden from the most senior political authorities in a country.

With respect to the communication to Governors itself, the Acting Chairman observed that its nature would be shaped to meet the particular circumstances of the case, and that could be made more explicit in the revised version of the staff statement. Some Directors thought that the communication should be part of the process of putting pressure on a country, but it had also been noted that it might be seen as a way of seeking support at a particular moment in time in an effort to help a country deal with its arrears. The tone and shape of the letter at that early stage should thus be determined by the circumstances. As reflected in the discussion, there was a preference that the draft of a formal communication either with all Governors or some subgroup of Governors be discussed explicitly in a Board session. That aspect of the procedure needed to be developed a little more in the revised staff statement.

Concerning the second letter, which would be sent after a declaration of ineligibility or in cases of protracted arrears, the sense of the meeting was that there was a preference for any such communication to be sent to all Governors. Some of the questions that had been raised about whether such a letter should go to heads of international financial institutions would have to be addressed by the staff in its revised statement to the Board. For example, a question had been raised as to whether sending a letter to heads of other international financial institutions would imply reciprocity.

The view was widely shared that sending too many communications to Governors should be avoided, the Acting Chairman noted. There was a need to be selective both in the number of communications, and the number of requests made in such communications, if they were not to be counterproductive. There should also be further reflection by the Board on the kind of requests to be made in such communications. Again, the staff, taking into account the discussion, as well as the suggestions that had been made, would incorporate alternative suggestions into the revised statement for consideration by the Directors.

With respect to the issue of censure or declaration of noncooperation, a relatively good majority was supporting the idea of some kind of declaration of noncooperation, the Acting Chairman considered. At the same time, some of those who supported the idea felt that as broad a consensus as possible should be reached before such a step was taken. It was for consideration whether that broader consensus could be shaped in the period before the meeting tentatively scheduled for August 18.

Among those who spoke in favor of some kind of a declaration of noncooperation, there were some consistent views on some of the questions and issues on which the staff had sought Directors' guidance, the Acting Chairman continued. With respect to the conditions for issuing the declaration, he noted that there was general support for the tests described on page 2 of EBS/89/128, although with differences of view as to whether there should be clear-cut, well-defined tests that did not leave a great deal of room for judgment, or alternatively left sufficient room for judgment. The reconsideration of these criteria was not necessarily excluded. That is yet another area for further reflection on the part of the Board to see if a consensus can be developed.

With respect to the content of the declaration, probably the strongest consensus on that issue had developed around not including references to a country's policies, particularly if the declaration were to be made public, the Acting Chairman stated. The question of publication was also an open issue, with some Directors feeling that such a declaration, if not published, would not have much effect, and others feeling more reticent about the idea of publication. The content of the declaration itself should on the one hand be clear and concise but on the other should give the Board the flexibility, if need be, in moving from one step to the next in the procedure. That too was an issue to which the Board would have to return.

On the timing of the declaration, there was a sense that the communication to Governors after the declaration of ineligibility should precede a declaration of noncooperation, or in other words, that the two declarations would not be made simultaneously, the Acting Chairman noted. Directors who spoke in favor of that approach saw it as a two-step procedure. As for the length of the period between communications, there were again differences of view, with some preferring a flexible period, and others a relatively short and precise one. That too was a matter to come back to in future discussions. Among those who addressed the issue of who would make the declaration--the Executive Board or the Board of Governors--there was support for the Executive Board taking such a step rather than the Board of Governors.

Those were some of the preliminary conclusions that he would draw from the discussion, recognizing that a good deal of work needs to be done to reach a consensus, the Acting Chairman concluded. He asked whether Directors might find it useful to continue the discussion on Thursday of next week, to help prepare the basis for the August 18 discussion.

Mr. Nimatallah remarked that in order to save time for the Board, he could envisage two decisions being taken simultaneously during the period preceding the declaration of noncooperation. On the occasion of a review of a member's overdue financial obligations, it could be decided that a communication should be sent to Governors, and also that the declaration of noncooperation would take effect after a stated interval of, say, anything from three months to six months.

Mr. Goos said that it would be helpful if, in revising its statement, the staff could make more concrete proposals, including a basic draft formulation for the first letter to Governors, which could of course be adapted to circumstances, as indeed was the practice with respect to decisions on reviews of overdue financial obligations.

The Acting Chairman remarked that revisions of both draft letters would be put forward in the revised staff statement. The purpose of that statement would be to enable Directors to focus on the issues that had been raised, taking into account the guidance that had been provided during the discussion, and with a view to reaching an early agreement.

Mr. Posthumus reiterated his view that it would be helpful to have some assurance that declarations of noncooperation would seldom need to be issued.

The Acting Chairman responded that the objective of the whole effort was to find procedures to deal with what would hopefully be a limited set of cases of overdue financial obligations that did not exceed the number of existing cases. The emphasis during the discussion had been on preventive action and on the avoidance of further arrears. It was not the intention to establish procedures that were expected to be used on a regular basis because cases of overdues were not expected to be a regular feature of the Fund's activities.

The Executive Directors agreed to resume their discussion of procedures for dealing with members with overdue financial obligations to the Fund on July 27, 1989.

The Executive Board then took the following decision:

The Fund has reviewed Decision No. 8165-(85/189) G/TR, adopted December 30, 1985, as amended. (EBS/89/133, 6/29/89)

Decision No. 9215-(89/94) G/TR, adopted
July 19, 1989

2. BURUNDI - 1988 ARTICLE IV CONSULTATION, AND STRUCTURAL ADJUSTMENT FACILITY - THIRD ANNUAL ARRANGEMENT

The Executive Directors considered the staff report for the 1988 Article IV consultation with Burundi and requests for the third annual arrangement under the structural adjustment facility (EBS/89/115, 6/5/89). They also had before them a report on recent economic developments in Burundi (SM/89/115, 6/21/89), and an updated policy framework paper for the period 1989-91 (EBD/89/165, 6/2/89).

The Acting Managing Director made the following statement:

There follows for the information of the 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 Executive Directors of the Bank and IDA in their July 13, 1989 discussion in Committee of the Whole of a paper entitled "Burundi: Policy Framework Paper, 1989-91."

Executive Directors expressed strong support for the Government of Burundi's comprehensive structural adjustment program and effort to promote national unity. They noted with satisfaction the Government's efforts to broaden national political support for the program which should improve economic opportunities open to all Burundian citizens.

The Committee was concerned by short-term prospects for coffee. The importance of measures to promote export diversification and to maintain Burundi's external competitiveness particularly with respect to nontraditional exports was stressed.

Executive Directors commended the Government's efforts to rebuild national unity following the tragic events of last August. They understood the difficulties faced by the Government in implementing some of the reforms, but reiterated the importance of persevering with the implementation of the adjustment program.

Directors noted the importance of public enterprise and civil service reform and the introduction of a consolidated budget as a means of both improving the efficiency of public resource allocation and reducing the deficit. While progress has been made in this area, it was indicated that more is needed to accelerate the pace of reform and to promote a more systematic approach to budget and investment programming decisions.

Directors stressed the importance of targeted poverty alleviation programs as part of an overall strategy to mobilize popular support for the adjustment process and to protect vulnerable groups. But they also emphasized the need to maintain social expenditures at a level consistent with fiscal discipline, while improving their efficiency, and to promote employment opportunities. In this connection, the Directors urged more vigorous support for family planning efforts to reduce severe pressures on scarce arable land.

In addition, the Executive Directors raised a number of other points which they believed required careful consideration and follow-up in the future such as Burundi's low savings rate, high debt service ratio, the prospects for raising government revenue and the reaction of the private sector to the improved incentive structure.

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

The Government of Burundi has requested the third annual arrangement under the structural adjustment facility, in support of its adjustment program for the period January-December 1989. Although negotiations took place in January and February 1989, the Board discussion of Burundi's request has been delayed until now because the Government needed additional time to implement all prior actions and reach a final agreement with the World Bank on outstanding issues regarding the policy framework paper.

The program included four prior actions: the reform of the transaction tax base, an increase in the tax on beer, an increase in the water and electricity tariffs, and the collection of dividends included in the ordinary budget in an amount of FBu 3 billion. The first three measures were implemented as scheduled. The last measure, which was crucial as it was projected to raise 8 percent of total government revenue for 1989 and represented a very large increase over the previous years' dividends, required more time. The Minister of Finance advised the staff on June 6 that all dividends had been collected for an amount slightly larger than programmed.

The second reason for the delay was the protracted discussions between the authorities and the World Bank on the public investment program (PIP) and on the magnitude of the increase of electricity tariffs to ensure the viability of REGIDESO, the utility company. The PIP has now been officially adopted by the Government, and an agreement has been reached on measures to reduce the cost of producing electricity and to raise tariffs. The policy framework paper was approved by the Committee of the Whole of the World Bank on July 13.

Available information received for the first four months of 1989 indicates that, thus far, the program is broadly on track. Benchmarks for March were met and those for June seem within reach. At end-April, government revenue was FBu 2 billion lower than anticipated because of the delay in collecting dividends, and government expenditure was slightly less than programmed. Net official reserves were larger than foreseen. However, inflation seems to have picked up, owing to much higher food prices as a result of the bad weather experienced during the first months of 1989. It is expected that, with the return of normal weather conditions and the harvesting of the new food crop, inflation will abate. However, uncertainty remains on the short-term prospects for coffee in the wake of the collapse of the International Coffee Agreement. Although world prices are now projected to decline, the effect on Burundi's balance of payments outcome may not be significant as prices obtained during the first months of 1989 have been higher than anticipated and larger volumes can be exported in the absence of quota.

Paragraph 1 of the third annual arrangement in Appendix II to EBS/89/115, should be corrected to refer to the third loan as being in an amount equivalent to SDR 8.54 million, the staff representative from the African Department noted.

Mr. Monyake made the following statement:

On behalf of my authorities, I wish to express appreciation for the staff analysis of the economic policies of Burundi and for its assistance in the preparation of the policy framework paper for the period 1989-91. My authorities concur with the thrust of the staff appraisal. Since the papers have succinctly reviewed the economic performance in 1988 and outlined the medium-term financial and structural measures to be undertaken by my authorities, I will restrict my comments to a few salient issues which underscore the degree of adjustment achieved, the sociopolitical setting, and the remaining ground that is to be covered in the medium term.

The Burundi authorities recognize that considerable progress has been made in structural adjustment since mid-1986, with the support of the first and second annual arrangements under the Fund's structural adjustment facility, concurrently with the structural adjustment loan (SAL) from the World Bank. At the same time, they are equally aware that medium-term balance of payments prospects remain vulnerable, especially in the light of uncertain prices for their main exports, notably coffee. Directors are, no doubt, aware of the recent collapse in the negotiations for a new agreement under the International Coffee Organization (ICO). The authorities, therefore, see the need for sustained structural adjustment effort well into the mid-1990s.

Over the last three years the authorities managed to attain an average annual GDP growth rate of 3.8 percent which is to be stepped up to 4.5 percent under the next three-year program for 1989-91. The rate of inflation, which was sharply lowered from its peak level of 7 percent in 1987 to 4.5 percent, is to be further reduced to 4.0 percent by the end of the program. Directors must have also noticed the substantial progress registered in reducing financial imbalances in the fiscal and external sectors, and although the adjustment in the fiscal area fell somewhat short of target due to unforeseen circumstances in 1988, the external current account deficit was reduced well beyond the program target. The most serious unanticipated setback to the 1988 program was the ethnic unrest which occurred in August, resulting in widespread destruction of life, institutions, and property, with repercussions on resource allocation and socio-political sensitivities which will continue to influence the design and implementation of fiscal measures under the 1989-91 program.

The commitment of my authorities to the structural adjustment program has been underscored by the personal support of the President of Burundi at various public occasions, including the recent Donors' Round Table Conference held in Bujumbura in April. Their commitment to maintain the established track record in structural adjustment was further confirmed early this year. All the slippages under the 1988 program have been adopted as prior actions for the 1989 program, notably in the fiscal area where the overall deficit (excluding grants) had been reduced by 7 percentage points of GDP instead of 7.8 percent. Under the 1989 program, the objective is to restore the steady declining trend in the level of the deficit through further reduction of the deficit (excluding grants) from 11.6 percent of GDP to 9.2 percent of GDP, despite a sharp increase in capital expenditure. The fiscal improvement in 1989 is attributable to a remarkable revenue performance resulting from intensified collection of tax arrears, the transfer of dividends from public enterprises, increases in tax rates and increased yield of import duties resulting from ongoing import liberalization. The revenue measures taken as prior actions, which are already in place, include the broadening of the transactions tax base, the increase in the tax rate on beer, the upward adjustment in water and electricity tariffs, and the collection of dividends from public enterprises.

With regard to the priorities in the use of public resources, the authorities are strictly adhering to the fifth Five-Year Development Plan (1988-92), the 1989-91 Public Investment Plan (PIP) which has now been submitted to the World Bank, and the Public Expenditure Programs (PEP) for 1989-91 which place first priority on agriculture and rural development. The ethnic unrest of August last year, mentioned earlier, did not only lead to destruction, with implications for resource allocation for reconstruction that is now under way, but the composition of public expenditure and civil service reform under the structural adjustment program is receiving more careful sociopolitical considerations.

The authorities made some progress in public enterprise reform, but more remains to be done under the 1989-91 program to promote efficiency in resource allocation and reduce the burden on the government budget. As explained in the staff report, the government policy is to restructure those enterprises which will be retained for strategic or other reasons, privatize enterprises that are otherwise valuable but do not require to be run under public control, and liquidate those which are nonviable. My authorities are proceeding satisfactorily in collaboration with the World Bank under SAL II.

With the Fund's technical assistance the authorities' structural reforms in the monetary sector will enhance market orientation while strengthening the Central Bank's supervisory capacity. In 1989, the authorities will complete the process of deregulation; the ground was largely covered last year, as outlined in Table 1 of Appendix II in EBS/89/115. Under this year's program, maximum lending interest rates will be abolished and the authorities will put into practice new policy instruments such as mandatory reserve requirements. They will also continue to strengthen and broaden the institutional infrastructure to promote the efficacy of monetary policy.

On the external sector, Directors will have seen the tremendous improvement in the reduction of the current account deficit (excluding grants) from 19.0 percent of GDP to 14.8 percent in 1988. The extent of the adjustment was 4.8 percent of GDP beyond the program target. My authorities recognize that to a large extent, this was facilitated by the sharp real effective exchange rate depreciation that more than reversed the entire appreciation of the decade of the 1980s since imports had been considerably liberalized in 1988. Nevertheless, in 1989 and beyond, they have decided to continue the flexible exchange rate policy and import liberalization to give further impetus to exports, especially nontraditional exports destined for the Preferential Trade Area (PTA) of eastern and southern African countries. In fact, on the basis of the exchange rate, Burundi has already gained comparative advantage within the PTA market and the authorities are now focusing on greater tariff reductions in the market. They hope that the exchange rate policy and trade liberalization will contribute to the structural improvement in their balance of payments in the 1990s. They are aware, however, that this transformation is gradual by its very nature and, given the sharp increase in development-related imports in 1989-91, the current account deficit will re-expand. Indeed, as projected in the policy framework paper (EBD/89/165), the balance of payments will remain under severe pressure in the next five years because of the rising current account deficit, the need for landlocked Burundi to maintain a cushion of foreign exchange reserves of about four months' import coverage, and the necessity to avoid nonconcessional external borrowing due to the high debt service burden. Burundi will therefore require considerable concessional assistance from bilateral and multilateral sources, including debt relief, in order to maintain the moderate rate of growth in per capita income and attain a viable balance of payments position.

As the authorities are now in the third and final year of the structural adjustment arrangement, they intend to seek Fund support under the enhanced structural adjustment facility for the pursuit of their medium-term structural adjustment for the subsequent years.

Mr. Menda made the following statement:

This chair welcomes Burundi's updated policy framework paper, which aims at reinforcing the results of the program launched in 1986. The objectives of restoring a rate of growth of 4.5 percent and of reducing the rate of inflation to 4 percent, together with stabilizing the current account deficit, seem reasonable, according to the performance observed in recent years.

We note with satisfaction the fact that Burundi, despite serious domestic disturbances, completed its second-year program under the structural adjustment arrangement, staying broadly in line with its objectives and complying with most of the structural benchmarks. Burundi's situation, however, remains fragile and very dependent on external factors. The third annual arrangement under the structural adjustment facility should provide the opportunity for Burundi to strengthen the present transitional phase toward the sound functioning of its economy.

The staff report shows that the economic situation may already have been corrected because of the progress achieved in the areas of exchange rate policy, trade policy, and the liberalization of the financial sector. The staff of both the Fund and the Bank have provided useful assistance in designing the program, and since I agree with the thrust of the staff report, I will only comment on its main features, dealing first with macroeconomic policies and structural reforms.

Fiscal policies will be the essential factor in releasing the resources needed to obtain higher investment and to sustain the growth rate of the economy. I agree with the staff that the key element will be the reduction of the overall fiscal deficit. Measures taken to enhance revenues are encouraging, particularly those taken to increase the share of noncoffee revenues and to improve the tax collection system. But the containment of government expenditure, including a strict control on personnel expenditure and recruitment, will be essential. Furthermore, accelerating the pace of reform of the parastatal sector will be a welcome contribution to the reduction of the public deficit.

It is clear that fiscal developments may complicate the implementation of monetary policy. Therefore, the Government's recourse to the banking system should be closely monitored in order to avoid inflationary pressures and to provide adequate credit to the private sector. I welcome the progress already made in stabilizing inflation and in fully liberalizing interest rates.

Turning now to the external sector, the authorities must be commended for the flexible exchange rate policy followed during recent years. They should closely monitor developments in this area with a view to maintaining the competitiveness of Burundi's exports. Measures already taken to liberalize the trade regime and exchange restrictions are most welcome features of Burundi's economic policy and should make an essential contribution to stimulating the export sector.

Given the remaining large external imbalances and the heavy external burden, the authorities should continue to rely solely on external assistance at highly concessional terms.

Concerning structural reforms, increasing the share of private investment is most critical to reaching the growth objective set by the program, together with a major reform of the public sector. The policy framework paper defines the strategy to be implemented in this area, with a focus on the primary sector, aimed at increasing revenues from coffee, and developing services and industrial subsectors related to this major source of export revenue. Lastly, the reform of the financial sector will play an important role and should help to ensure a better allocation of resources.

To conclude, it is clear that Burundi will still need the support of the international financial community in the years ahead. I support the proposed decisions and wish the authorities well in their endeavors.

Mr. Goos said that he shared the disappointment of the staff over the deterioration of the macroeconomic framework, after two years of support by the structural adjustment facility, notably with respect to the fiscal position and the domestic savings ratio, and as reflected in the weakening in the external current account. Of course, he recognized that the tragic social developments the authorities had had to face in 1988 no doubt had had an impact on actual economic developments. But the actual performance also reminded him of his chair's repeatedly expressed concern that the envisaged pace of adjustment under the structural adjustment facility program had probably been too slow from the outset. Moreover, it was regrettable to learn from the staff report of slippages and delays in the implementation of agreed program measures. Therefore, he could not but agree with the staff's view that the authorities obviously needed to strengthen their commitment to growth-oriented adjustment. Indeed, as had been emphasized by Mr. Menda, that need was particularly pressing in the fiscal area. While it appeared that the authorities were moving in the right direction, and the envisaged correction was indeed impressive, he had some doubt, given present policies and considering the record of slippages, whether the fiscal revenue objectives were really attainable. At the same time, he wondered whether the fiscal adjustment effort did not focus unduly on revenue enhancement, in that it might be inconsistent with the intended promotion of private sector initiative.

Last, but not least, it had to be noted that some of the program's revenue measures for 1989 were of a nonrecurrent nature, and therefore would require timely follow-up measures that remain to be identified, Mr. Goos went on. Thus, it appeared that additional efforts should be directed toward reducing fiscal expenditures. The staff had clearly pointed out the areas for corrective action. Corresponding attention should be given in particular to the reform of the public enterprise sector and to the efficient design of the public investment program, in cooperation with the World Bank.

With respect to the latter program, flexible implementation of the ambitious spending plans would appear to be advisable in order to avoid undue pressures on domestic inflation and the resources available for private sector activity, Mr. Goos observed. In that respect, he reiterated the view he had already expressed at previous Board discussions that it was not so much the volume but the quality of investment that determined overall growth, and in particular its sustainability.

Monetary policy was an area that would have deserved more attention than it was given in the staff report, given the projected low domestic savings ratio and the need to step up investment in a sustainable manner in order to broaden the productive base of the economy, Mr. Goos considered.

In that context, he strongly recommended that the authorities speed up financial sector reform to improve the responsiveness of domestic savings to interest rates, which he assumed were generally positive in real terms, though regrettably, that important feature had not been addressed in the staff report. The latest World Development Report of the World Bank offered a wealth of compelling information on the crucial importance of a well functioning financial market to overall growth and stability.

As to exchange rate policy, Mr. Goos said that he welcomed the recommendation in the staff appraisal that the current, already substantially depreciated level of the exchange rate should be maintained in real terms, and that the staff had refrained from expressing its standard advice to pursue an active exchange rate policy, in the form of further continued depreciation. Under present circumstances, it appeared appropriate to counteract possible pressures on the exchange rate through a tightening of financial policies. Such a policy response, to his mind, would in general also be an appropriate course of action, should the medium-term balance of payments outlook deteriorate. In that context, he was somewhat puzzled by the fact that the pronounced depreciation of the currency over recent years had not been translated into a higher inflation rate, and he would welcome staff comment on the reason.

Finally, Mr. Goos said that he also welcomed the envisaged strengthening of official reserves, which should provide the program with a cushion against unforeseeable developments. At the same time, one would have wished that the authorities had moved more vigorously toward removing exchange and payments restrictions. In that respect, he wondered whether the liberalization of imports of luxury goods was really a cause for as much celebration as it would appear from the staff report.

He endorsed the staff appraisal and supported the proposed decision.

Mr. Codrington said that his chair supported the request for the third annual arrangement. However, a number of issues needed urgent attention if Burundi was to maximize the benefits from the structural adjustment facility. In a country where government participation in the economy was so pervasive, it was crucial that financial discipline be a prime feature of the public sector itself. Therefore, the recent attempts to contain the fiscal deficit by tax reform, improved management and more efficient public enterprises were encouraging. A reduced deficit within the context of flexible interest rates and prices, and some financial deepening, would allow for enhanced private sector involvement; there would also be a higher likelihood of achieving the increase in national savings projected during the medium term. While referring to the public sector, he wondered whether the 41 percent growth in revenue projected for 1989 was not somewhat ambitious.

His chair was pleased that the authorities recognized the dangers posed by so narrow an export base and were taking steps to redress it, Mr. Codrington said. To begin with, diversification would reduce the uncertainty surrounding government revenues arising from the volatility of coffee prices. Second, production of manufactured items with higher income elasticities could lead to a quicker increase in foreign exchange earnings, a reduced debt-service burden, and a higher import cover. In that regard, he suggested that foreign direct investment, which was currently very low, be encouraged as part of the promotion strategy for the export sector.

Finally, one objective of the Fifth Development Plan, which ran until 1992, was to raise per capita GDP by 2 percent, Mr. Codrington noted. Any increase in per capita income would require some success in the effort to control population growth, and his chair wished the highest priority to be attached to that part of the program.

Mr. Jones made the following statement:

> The new information in the statement by the staff representative in respect of Burundi's performance under the proposed program for 1989 is very encouraging, in particular because of the way in which slippages in 1988 have been recovered.
>
> Nevertheless, there is still much in the Burundi economy that gives cause for concern. The debt burden is heavy and large flows of concessional external funds remain essential, as Mr. Menda noted. Growth in output last year fell short of projections and remains uncomfortably close to the rate of population growth. The improvement in the current account, although helped in part by exchange rate flexibility, owed more to the windfall gain of higher coffee prices and import compression associated with delayed aid disbursements. The fiscal deficit fell less than expected, despite the benefit of higher coffee revenue, because of delayed tax reform and overruns in expenditure.
>
> Clearly, the Burundi authorities have made some headway but still face a long struggle to consolidate the fiscal position and reduce the debt service burden, while attempting to ensure that economic growth outpaces the growth of population. I see only too clearly the importance of growth, but nonetheless I am rather surprised by the apparent change in course proposed for the third year of the structural adjustment arrangement, which places emphasis on lifting growth with an accompanying deceleration in the move toward external viability.
>
> Such a strategy is clearly not without risks. I do have some misgivings about the increase in, and persistence of, large residual financing gaps, and the associated dependence on further concessional resources. This concern is heightened by the degree of sensitivity to adverse movements in the terms of trade and other exogenous factors. Even with the proposed measures of export diversification, dependence on coffee remains heavy, and its significance has been highlighted by the collapse of the International Coffee Agreement. As the staff notes in its

analysis, the authorities must recognize that any adverse developments will lead directly to a need for greater adjustment efforts.

In respect of the projections of higher growth, I agree with Mr. Menda that raising the level and effectiveness of investment is clearly a key factor. Two elements are critical in this context. The first is a further reduction in the fiscal deficit. Capital spending is programmed to increase in 1989 before declining as a percentage of GDP; I am reassured that these resources will be used well, through the involvement of the World Bank in the public investment program, but an offsetting cut in real terms in current spending is required. While noting the emphasis placed by the staff mission on the importance of avoiding extrabudgetary spending, the recent problems in Burundi must make resisting spending pressures more difficult, as I think Mr. Monyake implies in his statement.

On the revenue side, the intention to reduce the dependence on coffee income is welcome, but last year's record of delays in implementing tax improvements does not provide much comfort. I hope the recommendations of the Fund's technical assistance missions bear fruit soon.

The central importance of reducing the fiscal deficit stems as usual from the need to release resources to the private sector, on which the program places appropriate emphasis. The Government's recourse to bank credit must be restrained if the program's credit ceilings are to be met, and the private sector is not to be starved of credit for investment. Nor would it be sufficient to depend on nonbank financing as an alternative to fiscal control.

The second critical element in attaining the revised program targets, and closely related to the fiscal position, is the reform of the parastatal sector. This was another area in which slippages from the proposed program of action were notable last year; it is to be hoped that the authorities will take full advantage of the assistance provided in this area by the World Bank. One welcome development is the decision to phase out subsidies to this sector, with the accompanying fiscal benefits. Given the importance of following through the proposed but delayed reforms in the parastatal sector, one is led to ask whether there might not be some role for a structural benchmark here. As set out in both the policy framework paper and the staff report, the plan of action is vague and ill specified.

The external policy reforms pursued by the authorities have allowed movement toward a more liberal trade and foreign investment regime and I hope that it will be sustained. The flexibility shown in terms of the exchange rate has also been of great value; in view of the external vulnerability of the economy and its heavy dependence on one export, this flexibility must continue to be pursued with great diligence where appropriate.

In many respects, the third-year structural adjustment arrangement bears resemblance to what we might expect to see in an enhanced structural adjustment arrangement, with the greater emphasis on investment and growth having its counterpart in a delayed correction of the fiscal deficit. If the pursuit of higher growth is not to prove mistaken in its anticipation of fiscal and external consolidation, the authorities must ensure that they achieve their targets. If there are serious slippages or adverse exogenous developments, they will have to make swift adjustments. These will safeguard the many economic gains the authorities have already achieved and will allow them to continue their pursuit of economic adjustment with support from the Fund.

I support the proposed decision, but in doing so I would welcome staff clarification on one point, concerning the timing of the program. Starting as it does, or did, in January of 1989, so-called prior actions were actually simultaneous with the program itself. I wonder why the program is not starting now, since there was after all a delay between the first and second years of the structural adjustment arrangement.

Mrs. Hansen made the following statement:

Since we are in broad agreement with the staff papers, I will confine my remarks to a few observations.

We commend the Government of Burundi for its resolve to continue its adjustment program, despite a difficult internal situation. Clearly, a number of important policy actions have been taken in the context of this program, such as those on exchange rate policy, trade liberalization, and interest rate deregulation. Meanwhile, there have been some improvements in Burundi's macroeconomic performance.

That being said, there are several areas where we see scope for further action. One crucial area is fiscal policy. We welcome efforts to improve noncoffee revenues, by making the tax system more comprehensive and improving tax administration. However, more attention also needs to be given to the expenditure side. The staff report mentions that the Government has taken two important decisions which could help control expenditures in the future: to phase out indirect subsidies granted to public enterprises, and to review recruitment policy and complete a study to rationalize the civil service. Perhaps the staff would comment on when these decisions are to be implemented. I note that the civil service study, which was supposed to have been completed by June 1988 under the previous structural adjustment arrangement, has not yet been done, and that civil service recruitment has been higher than programmed.

With regard to structural reform, the staff appraisal identifies reform of the parastatals as an important area where policy action has fallen short of expectations. Indeed, the second-year arrangement called for a number of actions to improve performance and begin rehabilitation of public sector enterprises, but few of these were actually carried out. We would urge the authorities to make progress in this area, both as a means of controlling public sector financial losses and of accomplishing the Government's goal of providing greater scope for private sector activity. Like Mr. Jones, we wondered whether a structural benchmark in this area might not have been appropriate.

On the external side, we note that an increase in development expenditures will cause the current account deficit as a share of GDP to rise this year and to decline only gradually in the following two years. This underscores the importance of implementing carefully the investment program agreed with the World Bank, so as to develop a stronger and more diverse productive base over the medium and long term. It will be equally important for the authorities to maintain their strong commitment to a flexible exchange rate and continued trade liberalization.

In conclusion, we recognize that Burundi's domestic situation may at times complicate the implementation of its adjustment program. Nevertheless, the Government's efforts so far have contributed to a stronger, more stable economy. We hope, therefore, that the authorities will persevere, even in the more sensitive policy areas, so that Burundi will reap the full benefits of its adjustment efforts. In this connection, we hope that performance under this third-year structural adjustment arrangement will be such that next year the Board can give serious consideration to Burundi's intended request for an enhanced structural adjustment arrangement.

Mr. Al-Jasser observed that although the macroeconomic framework of Burundi's economy had not shown much improvement, the authorities were to be commended for their perseverance with the adjustment program started in 1986, despite adverse internal and external conditions. Particularly commendable were the maintenance of a flexible exchange rate; the attainment of a relatively low rate of inflation; the liberalization of interest rates, and, last but not least, the sound management of Burundi's external debt, which lowered the debt service ratio and the interest rate on that debt while increasing its average maturity from 23 years to 40 years.

The challenges facing the Burundi authorities during their Fifth Development Plan (1988-92) were nonetheless formidable, Mr. Al-Jasser noted. The economy's productive base was still narrow, which necessitated accelerating the diversification of the economy, especially its export sector. The stalled reform of the parastatal sector should be resumed because it was crucial to improving the allocative efficiency of the economy. In that regard, the possibilities of privatization should be pursued in order to enhance the role of the private sector in the economy.

Obviously, the national saving rate, at 3.7 percent, was still very low, Mr. Al-Jasser commented. He hoped that the ongoing liberalization of interest rates on deposits and the reform of the tax system, in conjunction with improved opportunities for private investment, would lead to a higher saving rate. That was crucial for the long-term viability of the economy and the sustainability of its growth rate.

As for the policies to be pursued by the authorities in the medium term, Mr. Al-Jasser considered that they were on the right track as long as there were no slippages during their implementation. Moreover, rationalization of the operations of the leading sectors of the economy, such as the coffee sector and the public enterprises, could go a long way in setting the right example for the rest of the economy. In addition, he agreed with Mr. Monyake that the measures implemented prior to the approval of the third annual arrangement under the structural adjustment facility were good proof of the authorities' commitment to restructure their economy on a sound basis. He supported the proposed decisions.

Mr. Ichikawa made the following statement:

Burundi was one of the first countries to apply for a program under the structural adjustment facility in August 1986. However, the progress of structural adjustment since then has been on the disappointing side. Economic performance during the first two-year program period was weaker than expected. The inflation rate in 1988 was lower than projected in terms of consumer price increases, but the growth rate was also much lower than targeted. In 1987, exports declined and the current account deficit increased. Although Burundi achieved a large increase in exports, in f.o.b. terms, and concurrently reduced its current account deficit in 1988, this was largely due to the windfall gain from the increase in the price of coffee exports. The relative weakness of the structural adjustment is evidenced by the zero growth in export volume in 1988 as well as by the low growth rate of GDP.

The delay in structural adjustment reflects poor macroeconomic adjustment by the authorities. The fiscal deficit of 1988 is running at more than 10 percent of GDP, despite the unanticipated increase in revenue from coffee exports. This is largely due to the Government's inability to implement appropriate adjustment policies, such as tax reform, because of internal disturbances. The unanticipated increase in exports was offset by the slippage in both expenditure and revenue. The fiscal structure has not improved and remains susceptible to exogenous elements, inter alia, the price of coffee in the international market. In addition, as the staff report noted, the lack of adjustment efforts also led to the slippage in "overall domestic credit expansion, the reduction of domestic arrears, and external net official reserves."

As this chair emphasized when the Board considered Burundi's original request for a structural adjustment arrangement (EBM/86/133 and EBM/86/134, 8/8/86), the structural adjustment facility is intended to facilitate the structural adjustment of an economy based on the pursuit of sound and disciplined macroeconomic policies. Without the implementation of sufficiently strong and extensive programs, the importance of the facility will be significantly reduced. We strongly urge the authorities to accelerate the implementation of adjustment measures.

In this regard, we welcome the revised medium-term economic and financial policy framework paper. The paper appropriately recognizes the structural policy problems in Burundi during prior periods and aims at orienting the economy toward sustained growth over the medium term by emphasizing the revitalization of the private economic sector. At the same time, the policy framework paper takes a steady and gradual approach to transforming the structure of the real economic sector of Burundi, which appears to be reasonable, considering the country's extremely low rate of capital formation in the private sector.

However, in order to achieve successful structural adjustment along the lines described by the public investment program, it is necessary to establish disciplined macroeconomic policies as well as effective structural adjustment policies. In this regard, I have several comments on the 1989 program and the revised policy framework paper.

First, reduction of the fiscal deficits is the most important policy target for Burundi. Although the new policy developments in tax reform are welcome, the Government is urged to implement the new policies effectively. Particularly since the structure of revenue is still largely dependent on the performance of coffee exports, curtailment of expenditure is important. Since the authorities' experience in expenditure control appears to have been relatively ineffective, strict monitoring and control of expenditures will be required more than ever to keep the increase below the ceiling.

In relation to this point, one of the main elements of expenditure increase in the 1989 budget is the growth of public investment through public enterprises. Although it appears necessary for Burundi to emphasize public investment to promote economic growth because of the economy's dependence on public enterprises, efficient management of those enterprises is important as well. The authorities must make a firm commitment to raising the efficiency of the public sector.

Second, the maintenance of flexible exchange rates is welcome to maintain the competitiveness of Burundi's exports. However, to achieve durable improvement in the trade balance, diversification of exports is needed as well. We would appreciate a more detailed explanation of how the intended increase in exports over the medium term would materialize through the proposed policies.

Third, the stagnant growth of the domestic saving rate appears to be the most persistent problem. Without effective measures to raise the saving rate, Burundi's dependence on external resources, which is to be reduced under the structural adjustment facility program, would continue as the country proceeds with the ambitious investment programs. We would appreciate the staff's elaboration on the prospects of promoting the domestic saving rate and closing the financial gap.

Fourth, the adverse developments in the viability of the external sector, which are indicated by the growing external financing requirement, have been and will remain the most serious question with respect to Burundi's external adjustment. Although the staff report emphasized that the debt structure has been shifted toward highly concessional loans, Burundi's financing gap is projected to increase because of the delay in adjustment of the economy, a result that is more than disappointing in view of the original intention. The projection is so discouraging that it may raise questions about the appropriateness of the program.

It cannot be denied that we feel some hesitation in simply accepting the staff's view on the strength of Burundi's program. However, as Mr. Monyake emphasized in his statement, Burundi's authorities have indicated their willingness to implement structural adjustment and are undertaking some important first steps in various policy areas. These facts imply that there is still room for the Fund's support of Burundi's adjustment efforts.

Therefore, with these remarks, we support the proposed decisions on the Article IV consultation and Burundi's request for the third-year arrangement under the structural adjustment facility.

The staff representative from the African Department said that the staff was hopeful that the fiscal objectives were attainable. The evidence lay in the number of reforms that were in place, particularly with respect to improving the tax administration and tax collection machinery. Certain other measures had been taken relating to tax exemptions, as a result of a serious slippage in 1988. The responsibility for the policy of granting exemptions had previously been handled by a committee, but it had now been limited to the Minister of Finance only. Further improvements in tax administration were expected to be introduced during the course of the year. On the whole, therefore, the fiscal objectives were likely to be attainable.

Interest rates were positive in real terms, the staff representative noted, the process of decontrol, which was started in 1988, having been completed. The Central Bank was also moving, under the reform of the financial system that was being undertaken and that was necessary to improve the saving rate, toward indirect measures of controls. Moreover, the Fund was providing technical assistance to the Central Bank in moving toward the use of reserve requirements as opposed to the control of credit expansion.

As had been pointed out in the staff report, an increase in the rate of saving was crucial, and a number of measures had been indicated as being essential to that end, the staff representative said. The reduction of the overall budget deficit itself, reform of the parastatals, as well as the financial sector reform, would together lead to an improvement in the saving rate.

The rate of inflation had remained relatively low, despite the high rate of depreciation of the currency, first, owing to the strict control of credit expansion, and second, because of the significant increase in food production, the staff representative explained. Consequently, the food component of the cost of living index had declined to about 40 percent.

As for the need to emphasize control on the growth of the population, given the rate at which it had been rising, the staff representative noted that a program for that purpose was being worked out with the World Bank.

The main reason for the inception of the program as of January 1989 was the need to formulate the program to coincide with the budget cycle, which began in January, the staff representative explained.

A number of measures had been introduced aimed at diversifying exports, the staff representative noted. Those measures were related to an expansion in local processing and production, for instance, by improving the quality of the coffee and tea exported and by increasing the output of locally produced manufactured goods, in particular for export to the preferential trade area for eastern and southern Africa as well as to the Economic Community of the Great Lakes. In that way, Burundi's dependence on coffee could be reduced somewhat, but given the large size of the coffee sector, the decline in the share of coffee exports in total exports would be gradual.

The staff representative from the Exchange and Trade Relations Department, in response to a question by the Acting Chairman, said that the liberalization measures taken under the reforms that had been implemented covered not only luxury products but other items as well.

Mr. Monyake said that he wished to thank the Executive Directors for their understanding of Burundi's situation and for their constructive comments. He also wished to express thanks, on behalf of his authorities, for the external financial resources on concessional terms that were being provided to support the program and reforms being carried out in Burundi.

As a concluding remark, Mr. Monyake reiterated his suggestion that the Executive Board consider adopting a good system of the World Bank that enabled Executive Directors to visit developing countries and gain first-hand experience of their problems. He felt sure that such visits would influence the views expressed in the Board.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the thrust of the staff appraisal. They observed that following the inception of the program in 1986, Burundi had initially made encouraging progress in implementing its adjustment program. However, despite some improvements in 1988, the macroeconomic framework had weakened in recent years. Directors expressed regret that the deficits in the central government operations and in the external current account have increased since 1986. While recognizing that that was due, in part, to exogenous factors such as the larger than anticipated fall in coffee export prices in 1987, and the tragic social disturbances in 1988, they also believed that the absence of compensatory measures as well as delays in the implementation of structural measures contributed to the deterioration.

In assessing the authorities' program for 1989, Directors believed that the Government should strengthen its commitment to growth-oriented adjustment policies. They supported the incentive measures aimed at promoting growth, such as market-determined interest rates, tariff reforms, and flexible pricing policies.

Directors stressed the importance of reducing the overall fiscal deficit. They were encouraged by the revenue measures included in the budget and by the actions taken to strengthen revenue collection but believed that more emphasis needed to be placed on reducing expenditure. Directors urged the authorities to quicken the pace of public enterprise reform, which should contribute to improving fiscal performance, strengthening the domestic savings effort, and gradually reducing Burundi's dependence on foreign assistance. They emphasized the need for more effective control of recurrent budgetary outlays, including outlays on public sector employment. In addition, higher quality and greater efficiency of public investment was seen as essential to accelerate growth and to improve the public finances. Close collaboration between the authorities and the World Bank on the implementation of the public investment program was also seen to be essential.

Directors urged the authorities to strengthen the contribution of the private sector and to raise domestic savings and, to that end, to reform the financial sector. The programmed reduction in government liabilities to the banking system was critical to ensure adequate flows of finance to the private sector while avoiding inflationary pressures.

Regarding the external sector, the increase in the projected financing gap raised questions about the pace of current adjustment policies. Directors noted that over the medium term more progress needed to be achieved to reduce the large external imbalance and strengthen the foreign reserve position. Hence, adjustment policies and the investment effort should be aimed at expanding and diversifying the productive base and exports. In particular, to preserve the competitiveness of Burundi's exports, the authorities will need to closely monitor developments in the real effective exchange rate. The authorities were also urged to ensure that external financing is mobilized only on highly concessional terms so as to achieve a steady decline in the debt service ratio. Directors viewed the lengthening, and reduction in the cost of, Burundi's external debt as a favorable development.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Burundi's exchange measures subject to Article VIII, Section 2, and in concluding the 1988 Article XIV consultation with Burundi, in the light of the 1988 Article IV consultation with Burundi conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Burundi maintains the restrictive exchange measures described in EBS/89/115 in accordance with Article XIV, Section 2, except the exchange restrictions on foreign remittances of profits, dividends, and other income pertaining to international transactions, which are subject to approval by the Fund under Article VIII, Section 2(a). The Fund grants approval for

the retention of these restrictions until 1990 or the conclusion of the next Article IV consultation with Burundi, whichever is earlier.

Decision No. 9216-(89/94), adopted
July 19, 1989

Structural Adjustment Facility - Third Annual Arrangement

1. The Government of Burundi has requested the third annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress of Burundi in implementing the policies and reaching the objectives of the program supported by the second annual arrangement and notes the updated policy framework paper (EBD/89/165).

3. The Fund approves the arrangement set forth in EBS/89/115, Supplement 2.

Decision No. 9217-(89/94), adopted
July 19, 1989

APPROVED: March 6, 1990

LEO VAN HOUTVEN
Secretary