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Minutes of Executive Board Meeting 89/63

10:00 a.m., May 24, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	M. E. F. Jones, Temporary
	Shao Z., Temporary
	M. E. Hansen, Temporary
	L. Hubloue, Temporary
E. T. El Kogali	
	M. J. Shaffrey, Temporary
E. V. Feldman	
	M. A. Fernández Ordóñez
	C. Schioppa, Temporary
	S. K. Fayyad, Temporary
	N. Morshed, Temporary
M. R. Ghasimi	S. Rouai, Temporary
	K.-H. Kleine, Temporary
	R. Wenzel, Temporary
	S. P. Shrestha, Temporary
	V. K. Malhotra, Temporary
	L. M. Piantini
	H. E. Codrington, Temporary
Mawakani Samba	
Y. A. Nimatallah	
	M. Pétursson, Temporary
	D. Marcel
	G. Serre, Temporary
	G. P. J. Hogeweg
	T. Morita, Temporary

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

Also Present

IBRD: R. Key, Africa Regional Office, R. Sikander, Cairo, Egypt. African Department: M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; S. J. Anjaria, J. Artus, C. Briançon, I. A. H. Diogo, M. G. Fiator, J. Khallouf, A. B. Petersen. Exchange and Trade Relations Department: A. Basu, H. Hino, B. Fritz-Krockow, P. Lenain, R. M. Schramm. Legal Department: H. Elizalde, A. O. Liuksila, R. S. J. Martha. Advisors to Executive Directors: A. R. Ismael, J. Basiuk, P. Gorjestani, S. M. Hassan, P. D. Péroz. Assistants to Executive Directors: B. A. Christiansen, E. C. Demaestri, P. Kapetanovic, C. Y. Legg, J.-P. Schoder.

1. MAURITANIA - 1989 ARTICLE IV CONSULTATION AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1989 Article IV consultation with Mauritania and a request for an arrangement under the enhanced structural adjustment facility (EBS/89/83, 4/24/89 and Cor. 1, 5/15/89), together with a policy framework paper for 1989-91 (EBD/89/116, 4/24/89 and Cor. 1, 5/15/89). They also had before them a background paper on recent economic developments in Mauritania (SM/89/89, 5/8/89), and a statement by the Managing Director, which read as follows:

> 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 May 12, 1989 discussion in Committee of the Whole of a paper entitled "Mauritania: Policy Framework Paper, 1989-1991."
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> 1. The Executive Directors, meeting as a Committee of the Whole, reviewed the Third Year Policy Framework Paper for Mauritania, covering the period 1989/91. The Executive Directors generally commended the Government of Mauritania for its sustained efforts in implementing its adjustment program. The Directors noted that since October 1987, when the last policy framework paper was discussed, the Government has taken a number of significant measures with the support of IDA and the IMF. Progress was noted in public investment programming, banking sector restructuring, liberalization of the pricing and marketing system of local cereals, and rationalization of private sector incentives, though several speakers noted a weakening of economic performance in 1988. There was general support for the main program objectives for the next three years. Several speakers emphasized the need for a close monitoring of both the economic reform program and the social situation.
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> 2. The Executive Directors raised five major concerns about the program:
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> (a) implementation prospects for the program in light of the recent social unrest;
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> (b) long-term growth outlook and prospects for private sector expansion;
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> (c) agricultural policies, including cereals pricing, land reform, fisheries, and environmental issues;

(d) resource mobilization and financing for adjustment; and

(e) the need to address issues affecting the poor, especially small farmers and those in rapidly growing urban areas.

3. Several Executive Directors expressed concern about the Government's ability to implement the adjustment program in the light of recent disturbances and the resulting dislocation of large numbers of people. It was noted by staff that the origins of the social conflict were complex and that the dislocations were likely to put an additional strain on already thinly stretched public services. This might make it necessary to reorient the priority for implementation of adjustment measures. Moreover, the political climate will be less conducive to tough but necessary economic reforms. This combination of factors raised questions as to whether the proposals of the policy framework paper remained feasible. The Committee noted the proposal for a mission to Mauritania to review whether any modifications to the Government's adjustment plans and timetable for implementation are warranted. The mission would also assess the implications for the Bank's program of assistance.

4. With respect to long-term growth prospects, it was noted that despite the vulnerability of Mauritania's economy and the limited prospects for diversification, there has been a significant supply response from the private sector in some areas of economic activity, mainly in fishing and irrigated agriculture. The Government has undertaken major reforms and important policy distortions have been corrected. Nonetheless, it is necessary to broaden the private sector response, particularly in agriculture, if long-term growth is to be assured. For this reason, several speakers urged the Government to avoid any slowdown in the pace of reform and to move ahead rapidly with the strengthening of the incentive framework, including trade, investment, monetary and fiscal incentives, as well as the restructuring of the banking system. Other speakers noted that the question of Mauritania's growth potential is overshadowed both by a heavy debt burden and by demographic pressures. Two Directors emphasized the need to view the Mauritanian economy in its regional context and to ensure that major policies are appropriately harmonized among neighboring countries.

5. In spite of the favorable growth performance of the agriculture sector in the last two years, it was noted that the projected growth of the sector is below population growth. Several speakers emphasized the need to expand and deepen the agricultural reforms already in place, in particular to reduce public sector intervention in marketing and irrigation, to streamline land tenure laws and practices, and to encourage crop diversification and increased cereals production through

further price liberalization. On environmental matters, the Committee urged the Government to give high priority to measures to slow desertification, accelerate reforestation, and conserve natural resources.

6. The Executive Directors stressed several points relating to the financial viability of the adjustment program and the size and availability of external support. Improved public finances are especially important for the success of adjustment. Speakers stressed the need to restructure public expenditures, accelerate public enterprise reforms, introduce further tax reforms, strengthen and rationalize import tariffs, improve tax and customs duty collection, and reduce budgetary transfers to public enterprises. Concerning the banking sector, the need to achieve long-term solvency of the banks and efficient financial intermediation was emphasized to improve domestic resource mobilization and allocation. It was noted that financial requirements in the next three years are considerable, but are expected to be met through continued donor support and debt relief. With respect to the debt burden, the staff noted that some progress has been made in the recent past, but emphasized the need for a positive response by the donor community to Mauritania's needs in the context of the special program of assistance to Africa.

7. Several Executive Directors stressed the growing importance of addressing the social impact of adjustment in the short term, especially the potential impact on urban unemployment of implementing reforms in the civil service and public enterprise sectors. While the establishment of the Employment Fund in 1985 was commended, it was also stressed that future adjustment programs will need to continue to address the social costs of adjustment, especially for small farmers, redeployed public sector employees, and those suffering from the current social unrest, specifically now that the inflow of refugees will impose additional social costs. Several speakers also pointed out that the education and health sectors should have high priority in public expenditure and project aid. In the long run, the private sector will have to generate the bulk of employment opportunities in the economy.

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

Since the issuance of the staff report, a serious communal conflict has erupted between Mauritanian and Senegalese citizens residing in each other's countries. According to published

the producer prices for domestically produced cereals will be raised, and their retail price will be gradually increased so as to cover the cost of processing and distribution. Moreover, the authorities intend to keep the price of food aid in main urban centers at a level that will encourage production of traditional crops. In the fishing sector, the new policy that is being followed focuses on the preservation of fish resources and on the protection of the hatcheries. Financial assistance for the implementation of the measures envisaged is being arranged through the World Bank and other bilateral partners. Overall, the authorities' objective is to encourage small-scale fishing industries that have the potential to raise domestic value added.

Regarding the public enterprise sector, its rehabilitation is at the center of the Government's efforts to enhance the contribution of the manufacturing sector to growth. To this end, the authorities will accelerate reforms already under way and improve the competitive environment in which these enterprises operate. The measures envisaged include divestiture, liquidation, and more private sector participation. It is the intention of the Government to reorganize and strengthen the management of key enterprises. In this respect, all import quotas and monopolies granted to manufacturing enterprises will be eliminated. The tariff system is being simplified, preferential regimes for import of inputs and material will be abolished, and price controls will be gradually dismantled. In addition, the enterprises will be encouraged to adjust their tariffs in line with increased costs in order to improve their financial performance. Regarding the mining sector, the authorities are preparing with the assistance of the World Bank a new restructuring package for the iron ore company SNIM designed to alleviate that company's debt burden, and to restore the mining sector's role as an important source of growth in the medium term. It is expected that this package will be put in place by end-1989.

Turning to the trading sector, the Government has lifted most price controls and administrative restrictions on trade in order to encourage private sector trade activities. In view of the need to improve the medium-term external situation, the Government has taken a number of measures to liberalize trade and stimulate export activities. These measures, which have been already initiated, involve a gradual removal of quantitative import restrictions and elimination of import license and the related import authorization. Moreover, the total elimination of the importer-exporter card is envisaged by 1990. The Government will also pursue a flexible exchange rate management, which should stimulate traditional and nontraditional exports as well as contribute to import substitution activities.

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

Since the issuance of the staff report, a serious communal conflict has erupted between Mauritanian and Senegalese citizens residing in each other's countries. According to published

reports, there has been a loss of civilian life, damage to private property, and population movements across the boundaries. An airlift was organized in the days immediately following the disturbances with assistance from Algeria, France, Morocco, and Spain that involved the repatriation of an estimated 60,000 people to both Senegal and Mauritania. It appears that the turmoil has subsided following the imposition of a curfew in both countries. Mauritania has appealed to the international community for support in resettling its returning citizens. A United Nations team has just visited the country and is preparing a program of action to be carried out by various UN agencies.

It is still too early to assess the full implications of the recent developments on the economic and financial situation of Mauritania. However, the Government has reaffirmed its continued commitment to the adjustment program, while searching for ways to address the needs of the returning population. In this context, the authorities have launched a national solidarity effort which, over the last few days, has raised UM 250 million (about $3 million) to help the returning Mauritanians. In addition, on May 10, 1989, the Government decided to set aside 5 percent of the 1989 budgetary appropriations for current expenditure (about UM 650 million or $8 million) to help those displaced to resettle in Mauritania.

The staff will continue to monitor closely developments in Mauritania and will conduct the discussions regarding the midterm review of the first annual arrangement under the enhanced structural adjustment facility in September 1989.

Extending his remarks, the staff representative from the African Department indicated that on page 44 of EBS/89/83, the date in the first line of the first paragraph should be April 17. Then under 1(b), the date on which the first loan would be available was not May 15, but June 15. On page 46 of the same document, the date April 17 should be inserted in paragraph 4 and in paragraph 5.

Mr. Mawakani made the following statement:

During the period 1985-88, the Mauritanian authorities implemented a comprehensive economic and financial recovery program aimed at removing structural impediments to sustained economic growth and at reducing internal and external imbalances. The recovery program was supported by three successive stand-by arrangements and two annual arrangements under the structural adjustment facility and by a World Bank structural adjustment credit. Under the program, positive results were achieved in many fronts. Real GDP growth is estimated to have averaged about 3.5 percent, reflecting mainly buoyant activities

in agricultural, fishing, and mining sectors. Fiscal and monetary policies became less expansionary and the inflation rate declined steadily. Furthermore, the competitive environment was improved, and the participation of the private sector in economic activity was increased. However, reflecting the slower than projected progress in strengthening the financial performance of public enterprises and delays in restructuring the banking system, the results of the external accounts were below expectations and difficulties relating to external debt servicing emerged.

Against this background, the authorities have adopted a comprehensive medium-term plan under which measures will be taken to further reduce key financial and structural imbalances in the economy, and to strengthen the external position while achieving a durable rate of economic growth in a stable domestic environment. In support of these objectives the authorities seek the continued support of the Fund under the enhanced structural adjustment facility, and the first-year arrangement thereunder.

The main objectives and policies to be pursued by the authorities during the period 1989-91 are detailed in the updated policy framework paper. The key objectives of the medium-term program are to achieve an average annual rate of real economic growth of about 3.5 percent; to reduce inflation, as measured by the GDP deflator, to about 4.5 percent; and to curtail the external current account deficit from 11.8 percent of GDP in 1987 to about 3.6 percent of GDP in 1991, thus allowing gross foreign reserves to be accumulated to about the equivalent of 2 months of imports, and gradually improving the external debt profile. The authorities' adjustment program is designed with special emphasis on further improving the competitive environment of the economy, and increasing private sector participation in all aspects of economic activity. To that end, the authorities intend to put priorities on further developing the agricultural and fishing sectors, as well as improving the management of public enterprises and the trading system.

In the agricultural and fishing sectors, the authorities have developed, in close collaboration with the World Bank, a program of action with the main objective of increasing these sectors' contribution to growth. The key policy elements in the agricultural sector are the rationalization of the investment program and the improvement of incentives for further private sector participation. In line with these objectives, the investment program in this sector will be geared toward improving irrigation, extension, and research services. Over the three crop years 1988/89 to 1990/91, the Government intends to encourage the private sector to increase the production and marketing of rice. To ensure adequate remuneration of farmers,

the producer prices for domestically produced cereals will be raised, and their retail price will be gradually increased so as to cover the cost of processing and distribution. Moreover, the authorities intend to keep the price of food aid in main urban centers at a level that will encourage production of traditional crops. In the fishing sector, the new policy that is being followed focuses on the preservation of fish resources and on the protection of the hatcheries. Financial assistance for the implementation of the measures envisaged is being arranged through the World Bank and other bilateral partners. Overall, the authorities' objective is to encourage small-scale fishing industries that have the potential to raise domestic value added.

Regarding the public enterprise sector, its rehabilitation is at the center of the Government's efforts to enhance the contribution of the manufacturing sector to growth. To this end, the authorities will accelerate reforms already under way and improve the competitive environment in which these enterprises operate. The measures envisaged include divestiture, liquidation, and more private sector participation. It is the intention of the Government to reorganize and strengthen the management of key enterprises. In this respect, all import quotas and monopolies granted to manufacturing enterprises will be eliminated. The tariff system is being simplified, preferential regimes for import of inputs and material will be abolished, and price controls will be gradually dismantled. In addition, the enterprises will be encouraged to adjust their tariffs in line with increased costs in order to improve their financial performance. Regarding the mining sector, the authorities are preparing with the assistance of the World Bank a new restructuring package for the iron ore company SNIM designed to alleviate that company's debt burden, and to restore the mining sector's role as an important source of growth in the medium term. It is expected that this package will be put in place by end-1989.

Turning to the trading sector, the Government has lifted most price controls and administrative restrictions on trade in order to encourage private sector trade activities. In view of the need to improve the medium-term external situation, the Government has taken a number of measures to liberalize trade and stimulate export activities. These measures, which have been already initiated, involve a gradual removal of quantitative import restrictions and elimination of import license and the related import authorization. Moreover, the total elimination of the importer-exporter card is envisaged by 1990. The Government will also pursue a flexible exchange rate management, which should stimulate traditional and nontraditional exports as well as contribute to import substitution activities.

In the 1989 program, the authorities have undertaken to achieve a real GDP growth of 3.2 percent, which will come mainly from appropriate incentives provided for private sector participation in productive sectors, and the restructuring of the public enterprise sector. Financial policies will also play a crucial role in generating domestic savings while curbing inflation.

In the fiscal sector, under the 1989 budget law, discretionary revenue measures have already been implemented. These include mainly increases in excise taxes on petroleum, rice, and sugar, as well as the reform of the minimum corporate tax. Moreover, an important fiscal impact is expected from the new investment code, which will reduce substantially the emphasis on import duty exemptions of new investments. The overall impact of these measures, combined with the projected expansion in the tax base, is estimated to reach 3.9 percent of GDP. The authorities' expenditure policy will be in line with the reoriented public sector role in the economy with more emphasis put on expenditure, education, and health services, while outlays on transfers and subsidies and on military personnel will be curtailed in real terms.

Regarding capital expenditure, the authorities will depart from the investment policies followed in the past, which raised external debt to a level at which it is having adverse economic and financial consequences. In line with this objective and with the renewed emphasis on private sector involvement in economic activity, the authorities will monitor closely with the World Bank the implementation of the investment program. This will help ensure that public investment program will be financed with a higher degree of concessionality and that timely implementation of projects will help to avoid capital expenditure overruns.

Despite these measures, the overall cash fiscal deficit is projected to increase to 5.5 percent of GDP, owing mainly to the impact of special expenditure items for the restructuring of banks and public enterprises, and to the repayment of external arrears. The overall fiscal position is expected to return to its medium-term path thereafter.

The conduct of monetary policy will continue to be prudent. Private sector credit expansion will be limited to about 6 percent while net government credit, excluding the restructuring of banks, is expected to be reduced by some 23 percent. The authorities believe that a rapid restructuring of the banking system will adequately support the emphasis on private sector participation. While they are seeking private participation in the capital of the commercial banks, these banks will start operating under management contracts with adequate financial

targets, so as to avoid the emergence of financial difficulties and the erosion of private sector confidence in the financial system. Moreover, the authorities will take steps to promote the use of market-determined instruments to allocate credit and encourage private savings. In this context, the authorities intend to establish an interbank money market shortly.

In line with trade liberalization and export promotion measures, the external current account deficit is projected to narrow significantly from 17.8 percent of GDP in 1988 to 13.6 percent in 1989. While the overall balance of payments deficit is expected to deteriorate further in 1989 mainly owing to the continuing outflow of capital, the situation is expected to stabilize shortly thereafter. The envisaged flexible exchange rate system will complement other demand-management policies in containing the potential effect of import liberalization on the reserve position. The external debt service during the period 1989-91 is expected to average SDR 145 million annually, or 37 percent of export of goods and services. The Government will soon examine with creditors various ways to achieve debt reduction including refinancing, debt conversion or repayment terms in line with the country's debt-servicing capacity and the medium-term balance of payments viability. In the meantime, administrative measures to improve debt management have already been put in place.

To conclude, the measures already put in place at the outset of the program are indicative of the authorities' strong commitment to implement the program. They believe that the measures they are implementing are appropriate to reach their medium-term objectives. However, they are aware of the vulnerability of the program to external shocks, and to the availability of highly concessional aid flows. Therefore, they can only hope that the support provided in the past, including generous debt relief, will continue to be available to support this adjustment program.

Extending his remarks, Mr. Mawakani said that his authorities had asked him to assure the Board that despite the conflict that had occurred between Mauritanian and Senegalese citizens, the authorities were still committed to the adjustment program on which they had embarked in 1985. He confirmed the contents of the staff representative's statement, and indicated that his authorities had already taken measures to assist those members of the population affected by the conflict.

Mr. Serre made the following statement:

This chair welcomes Mauritania's request for an arrangement under the enhanced structural adjustment facility as evidence of the authorities' commitment to tackle structural and financial

imbalances in a timely and adequate fashion. Indeed, as underlined by the staff's report, there have been slippages and delays in the implementation of Mauritania's adjustment program starting in 1985. In spite of the partial progress achieved in improving the domestic financial position by adjusting the interest rates and containing the rate of inflation, the current account deficit, as well as the accumulation of new external arrears, has continued to increase.

We are pleased that the thrust of the policy framework paper aims at reinforcing the external position and at achieving a durable rate of economic growth by containing aggregate demand policies and encouraging a diversified growth of the private sector, along with rehabilitating the public sector and the banking system. According to Mr. Mawakani's statement, the necessary consensus required within the Government to pursue adjustment policies has been achieved through this comprehensive policy framework paper.

As regards macroeconomic policies, prudent monetary policy continues to be a key element of the program as well as the restructuring of the banking system. Policy will focus on ensuring adequate availability of credit to the productive sectors while curtailing monetary expansion to contain the rate of inflation. Moreover, the simplification of the interest rate structure is laying the groundwork for market-determined instruments of credit development.

However, close monitoring of public finance to obtain a surplus consistent with the objective of covering amortization on nonrescheduled debt is a major element of the program. In this respect, the budget provides for a comprehensive restructuring of the tax and tariff system that aims at improving allocative efficiency. On the expenditure side, current outlays and transfers will be contained and the wage bill will be limited to cope with the need for exceptional outlays related to the restructuring of the banking system and public enterprises.

The improvement in Mauritania's economic growth is based on reforms which address significant structural weaknesses in the agricultural, trade, fishing, and public enterprise sectors. These reforms focus on a restoration of market-oriented measures, and in particular on appropriate price and production incentives, to encourage private sector production. In this respect, we urge the authorities to avoid further delays in implementing reforms related to the marketing agency (SONIMEX) and the food agency (CSA) in the cereal area, and in rehabilitating the water and power company (SONELEC), the Postal and Telecommunication Office (OPT), and the fish marketing board. Furthermore, the highest priority must be given to restructuring the mining company (SNIM) according to the program elaborated

with several donors. An improvement in the whole economic environment through the structural reforms described in the program is critical to its successful outcome.

Turning now to the external sector, we note that despite the comprehensiveness of the adjustment program, Mauritania's external position remains fragile as the overall balance of payments deficit is expected to deteriorate in 1989. Moreover, projected export earnings depend mainly on elements beyond the control of the authorities. This underlines the necessity to rely on domestic financial policies and on exchange rate policy in containing the possible effect of trade liberalization on the reserve position and on inflation. We would also like to stress that this program depends dramatically on adequate external financing, and in particular, on exceptional financing to alleviate the short-term consequences of the recent social unrest, in addition to the actions already taken by the authorities.

We agree with the staff's medium-term outlook analysis, which reinforces our conviction that the path to sustainable growth proceeds first and foremost by reinforcing economic and financial stability. There is no room for complacency at this stage of the overall adjustment process. We support the proposed decisions and wish the authorities well in their endeavors.

Mr. Nimatallah said that he welcomed the 1989 Article IV consultation with Mauritania and could strongly endorse the proposed arrangements under the enhanced structural adjustment facility. The new arrangement, which built on the achievements of the structural adjustment facility program initiated in 1986, appeared well designed to address most of the essential economic problems confronting the authorities. The structural elements of the program would provide the basic conditions for sustained growth through their effect on investment and production. That was especially evident for the agricultural sector and, in particular, the fishing industry. Special attention should be given to the sequencing of the reforms in order to maximize the positive impact of the restructuring of public enterprises and the banking system on the agricultural sector.

On demand management, the authorities were convincingly redressing existing macroeconomic imbalances at a pace that should facilitate the successful implementation of structural policies, Mr. Nimatallah noted. He was impressed by the fact that the major part of the planned reduction in the overall consolidated budget would be obtained through current expenditure reduction, and more specifically through wage restraint. That represented a courageous choice and demonstrated the commitment of the authorities to the success of the program.

Furthermore, demand management was supportive of the achievement of the external sector targets, Mr. Nimatallah commented. By providing a cushion against unforeseen circumstances, the authorities were being prudent in their assumptions of future export revenues, both in terms of volume and prices. Therefore, he supported the program, which seemed to have struck an adequate balance between its various macroeconomic, structural, and external components.

He hoped that the participation of Mauritania in the Arab Maghreb Union would help further in the successful implementation of the program, and he supported the proposed decisions, Mr. Nimatallah concluded. He wished the authorities well and hoped that they received the full international financial support that they deserved.

Mr. Rouai made the following statement:

Since 1985, the Mauritanian authorities have made comprehensive efforts to restructure their economy with the aim of boosting growth and achieving internal and external equilibrium. To this end, they launched a bold three-year adjustment and rehabilitation program in early 1985, followed by a similar program for 1987-88. During this period, the country's efforts have been supported by the Fund under three consecutive stand-by arrangements and a structural adjustment arrangement. The response of the economy to these programs has been largely satisfactory, and the authorities' commitment to reforms and Fund-supported programs has been commendable. We are in broad agreement with the thrust of the staff appraisal and we can therefore support the proposed decision.

The authorities' achievements under a comprehensive demand-management policy through implementation of effective monetary and fiscal measures have been commendable. In fact, as a result of these measures, the authorities were able to improve gross domestic savings, to narrow their resource gap, and to reduce inflation. Concomitantly, GDP growth increased from -0.05 percent in 1984 to +2.5 percent in 1988. We note with satisfaction the increase in agricultural production. However, imports of foodstuffs, and of rice in particular, increased substantially owing to distorted relative agricultural prices, which resulted in a higher propensity to consume imported rice. In this respect, we urge the authorities to take further measures, including the streamlining of land legislation and the implementation of price liberalization so as to encourage production and enhance the quality of domestic foodstuffs.

The fishing industry is one of the main sources of exchange earnings in Mauritania. Notwithstanding a substantial increase in the exports of fish and fish products during 1985-86, this

industry showed a decline in recent years owing to inadequate state surveillance and weak production policies. We welcome the policy adopted by the authorities in 1987 aimed at improving the performance of the fishing industry.

With respect to the rehabilitation of public enterprises, we welcome the improvements in billing, accounting, and collection procedures, and in particular the strengthening of financial controls in the OPT, as well as the adoption of a new restructuring program for the iron ore mining enterprise.

As regards the banking system, we are deeply concerned that about 60 percent of total credits were irrecoverable in 1986. However, we welcome the implementation of the 1987 reform program; the adoption, in April 1988, of the banking law aiming at further restructuring and strengthening the banking system; and the reinforcement of the Centrale des Risques Departement to better assess the risks attached to bank credits, to ensure that credit is extended largely to productive activities. We also welcome the consolidation of commercial banks into viable financial institutions and the merging of the National Development Fund and the Mauritanian Bank for Development.

With respect to the economic objectives for 1989, 1990, and 1991, we believe that their attainment is mainly dependent on the authorities' determination to pursue adjustment, on a favorable international environment, and on sufficient access to grants and concessional loans. We hope that donors will continue to extend sufficient and timely concessional loans and grants to Mauritania so as to enable the country to sustain its adjustment efforts.

Mr. Wenzel remarked that he had little to add to the comprehensive staff analysis and recommendations. He was satisfied that the authorities were moving in the right direction, and believed their continued adjustment efforts deserved the Fund's support.

It appeared from the policy framework paper that the rigorous and timely implementation of structural measures was the key to the success of the program, Mr. Wenzel said. In that regard, however, the calendar of implementation of policy measures under the government program in the policy framework paper gave rise to considerable concerns. While he appreciated that the slippages shown in that table had been largely corrected, he nevertheless encouraged the authorities to improve the country's administrative capacity by making expeditious, rapid use of technical assistance. The need for technical assistance was also borne out by the information on outstanding statistical issues, which showed not only substantial weaknesses in the statistical data base, but also, and perhaps more worrisome, delays in the implementation of technical recommendations by the staff.

As to the envisaged policy measures, Mr. Wenzel indicated that he had no major difficulties. He would only underscore the need for strict adherence to the fiscal measures envisaged under the program. In that context, he cautioned that the projected strong increase in fiscal revenues, particularly after the experience of the previous year, might turn out to be on the optimistic side. At any rate, the authorities might be well advised to provide for additional measures in order to cope with unexpected developments, including the fiscal strains resulting from the communal conflict.

Determined implementation of the adjustment measures also appeared critical in view of the substantial shortfall in gross domestic savings that had occurred in the previous year and the prospect that it would be corrected only to a modest extent in 1989, Mr. Wenzel commented. He could support the proposed decisions.

Mr. Hubloue made the following statement:

> It is no easy task to implement high yield adjustment programs in countries whose absorption capacity is as small and whose natural constraints are as narrow as Mauritania's, a task that is now made even more difficult by the communal conflict that has recently erupted. If the authorities succeed in meeting the ambitious goals of the present program they will have shown that that task is not altogether impossible. Their efforts therefore have my full support. Ambition and determination will indeed be required to establish in Mauritania price and production relationships that guarantee a durable expansion of income to the entire population and facilitate the allocation of a sufficient fraction of export receipts to the servicing of external payments obligations. Mr. Mawakani correctly reminds us that the prior actions already taken should inspire our confidence in the Government's determination and dispel the uncertainties created by the rather poor policy performance of 1988.
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> Focusing the policy program on a few well chosen areas where structural reform can substantially improve income and balance of payments performance is the usual advice of this chair to low-income countries. However, this recipe may not fit the case of a country as poor in natural resources as Mauritania. The potential for expanding Mauritania's iron ore production will always be limited by the behavior of world demand, as suggested by the medium-term assumption in Appendix I to the staff report; exploitation of Mauritania's fish stock has reached the point where preservation, not further expansion, is called for; and possibilities for establishing a broader-based industrial and manufacturing sector are constrained by the small share of output which Mauritania can absorb domestically.

Slow, patient progress in all areas where a better utilization of scarce domestic resources can be obtained and prudent financial management of the external position thus seems to be the preferable option for a country like Mauritania. A number of African countries whose situations are similar have been following this strategy with increasing success. This also seems to be the strategy underlying the present program, which appropriately focuses on the allocation benefits to be obtained from the reform of the financial sector and from the establishment of better price and production conditions in the agricultural sector, an area where the adjustment might even have been faster than envisaged under the program.

One problem connected with such approaches, and one which in my view is very relevant to the case of Mauritania, is that they cannot seem to avoid confronting members with a multiplicity of areas in which policy measures are supposed to take place within a relatively short period: I discovered that the policy matrix attached to the policy framework paper includes no fewer than 25 policy areas or subareas where reforms are planned over the next three years. I seriously question whether Mauritania's institutional capacity will not be overwhelmed by such a multitude of actions, given the country's administrative limitations. These limitations are already evidenced by Mauritania's poor statistical data base, by the economy's recurrent difficulties with external debt management, and by the delays in policy implementation that have occurred under previous programs. The authorities seem fully aware of these limitations and have announced several welcome measures for reinforcing their economic management, but I fear that even after these measures are introduced, obstacles preventing the implementation of all the planned reforms may still arise.

Let me end with some general considerations on this issue. Ambitious though they are, and should be, our enhanced structural adjustment facility programs should nonetheless avoid overwhelming the members with a multitude of measures that cannot all be implemented at the same time because they collectively exceed the country's institutional capacity. This concern was frequently mentioned as one of the principal reasons for the disappointing results of the World Bank's first generation structural adjustment loans. It was also strongly emphasized by Mr. Jalan in the statement on conditionality that he circulated in early March. At the least, the staff should single out a limited number of priorities where full implementation is considered vital to the success of the program. The experience of Mauritania shows that adjustment measures that have been implemented may fall short of expectations in terms of growth and balance of payments results because certain other measures which were of vital importance had not yet been implemented.

A number of low-income countries seem almost systematically doomed to have poorer or less stable adjustment records than others, because their institutional and administrative bodies are poorly equipped to absorb comprehensive programs or adjust flexibly to a changing policy environment. The issue may deserve a more general analysis because it may well be true that what we now consider unwillingness or political failure to implement all aspects of a Fund program is often more correctly attributable to the country's institutional inability to implement the required measures. The results of such an analysis might thus considerably reinforce the argument for concentrating, and preferably intensifying, for members that have programs under the enhanced structural adjustment facility, both the Fund's own technical assistance functions and the technical assistance provided by donor countries in order to improve the members' implementation of Fund programs.

Mr. Hogeweg said that he very much appreciated Mr. Mawakani's statement that in spite of the regrettable conflict with Senegal, the authorities of Mauritania were still fully committed to their adjustment program.

They certainly deserved the Fund's support. However, in that context, he had noted the third paragraph of the World Bank memorandum on Mauritania, in which it was stated that several Executive Directors, including his own counterpart, had expressed concern about the Government's ability, as opposed to its commitment, to implement the program fully in the circumstances. He understood from that paragraph that the World Bank would send a mission to Mauritania to assess the implications and possible needed modifications. The Fund staff recognized the uncertainties involved, but seemed to have reasonable confidence in the authorities, which he appreciated. Close monitoring of developments had been mentioned as well as a midterm review in September.

He would welcome clarification of the link between the Bank mission mentioned in the text of the Bank summing up and the Fund mission on the occasion of the midterm review, which had not been made clear in the staff papers, Mr. Hogeweg indicated. It was very important that the two institutions move in parallel on those matters. It was clear that administrative capacity as well as a political environment conducive to tough but necessary reforms, as formulated in the Bank paper, were both very necessary to make the program a success.

Mr. Nimatallah noted that Mr. Hubloue had raised the issue of whether one should use a comprehensive approach or a piecemeal approach in regard to structural reform. He himself considered that the program in question appeared to be designed to address most of the basic economic problems. While he agreed that the program covered numerous areas, he would be hard-pressed to select which of them might be eliminated. The solution might be to allow the authorities a slightly longer time to implement the measures referred to in the paper.

The staff representative from the African Department pointed out that some of the measures that were envisaged in the policy matrix were, to some extent, in areas where catching up had to take place, since they had been under consideration since 1986. It was only now that the circumstances seemed ripe for putting those measures into place.

In some areas, such as the restructuring of the banking system, the reforms could have been completed about a year earlier, the staff representative added. Unfortunately, one of the key elements of reform of the banking system required that the Government obtain the cooperation of a foreign partner, and negotiations to that end had continued for about three years despite attempts by the World Bank to help find such a partner. The authorities were currently re-examining that issue.

The World Bank had been discussing with the authorities the possibility of a specific sectoral program to deal with the rehabilitation of public enterprises, and of SNIM in particular, the staff representative from the African Department indicated. In the past, related studies had had to be completed, but now the pieces were in place for the program to be implemented. Accordingly, the program would not be as demanding as might appear at first glance.

Mr. Hubloue said that he fully agreed with Mr. Nimatallah that, in the context of a structural program, the member country concerned had to make progress on all aspects. However, given the comprehensiveness of that approach, the Fund should stand ready at any time to give the country advice on those issues that were critical for the success of the program, and to provide the country with technical assistance if difficulties in implementation arose.

Mr. Wenzel remarked that Mr. Hubloue's concern should be taken care of by program reviews.

Mr. Nimatallah noted that the sequencing of priorities was critical in such cases. He of course agreed that countries should have access to all the technical help from the Fund that they might require.

Mr. Fernández Ordóñez said that he endorsed the three-year program and the program proposed for 1989 adopted by the authorities, and warmly supported their request for arrangements under the enhanced structural adjustment facility.

He welcomed the price and market liberalization in the agricultural sector, Mr. Fernández Ordóñez indicated. The recent increases in some prices and the sale of mills were evidence of the authorities' determination to implement that policy. He also welcomed the program of privatization and the reform of the public sector, as well as the adoption of the new investment code and the new tariff code. The proposed restructuring of the banking system was likewise an encouraging development. He supported the fiscal, monetary, and external policies described in the staff report and papers.

It was important, however, to maintain a certain flexibility in implementing all those policies, Mr. Fernández Ordóñez continued. The scenarios presented by the staff illustrated that the prospects for the Mauritanian economy were very sensitive to external developments as had been the case in the past, and he concurred with the staff that in the event of lower export prices or a lower volume of iron or fish exports, faster domestic adjustment would be required.

He would welcome staff comment on the degree of consensus over the program, Mr. Fernández Ordóñez remarked. Certainly, that was difficult to assess, but during the review of the structural and enhanced structural adjustment facilities, Directors had agreed on the importance of the question of "the ownership of the program." In the current case that was particularly relevant because when the staff had described the mixed results of previous programs, it had indicated that the main cause of the implementation difficulties, besides those factors that were beyond the Government's control, was the lack of consensus on how to proceed with the reforms. The point that had been raised by Mr. Hubloue, which was very important, could be of less concern if the authorities considered that they were implementing a program that was their own and one that they fully supported.

Mr. Shrestha made the following statement:

Both the staff report and Mr. Mawakani's statement suggest that the comprehensive economic and financial recovery program implemented during the period 1985-88 produced many positive results. The financial position improved, credit policy was restrained, the rate of inflation was lowered, interest rates were made positive, and real GDP growth averaged about 3.5 percent. The Government should be commended for these achievements. However, despite such gains, Mauritania's economy remains fragile, as reflected in the continued difficulties in the external sector in 1988, with an increased current account deficit and the accumulation of new arrears on external debt. In this context, the new strategy designed to promote reforms aimed at achieving structural adjustment and sustained growth deserves the Fund's support. The adjustment and structural reform program aims at strengthening the external position to a sustainable level and achieving a durable rate of economic growth under conditions of internal stability. Therefore, I can endorse the proposed decision.

Since I am in broad agreement with the staff appraisal, I will be brief in my comments. I concur with the staff that the continued weakness in the external position was due in part to slippages in the implementation of structural reform policies. The expansion of domestic credit in particular might have adversely affected the external sector, and the restructuring of the banking system as proposed in the program should help to tackle this problem.

On the external sector, I welcome the initiatives taken by the Government for stimulating export activities and liberalizing external trade. These measures toward improving the medium-term external situation will certainly promote greater competition and thus increase productivity and improve resource allocation. Similarly, I welcome the Government's decision not to increase the short-term debt in view of the already high level of outstanding external debt. In this context, the implementation of administrative measures to strengthen debt planning, monitoring, and management are important steps in avoiding any recurrence of external payments arrears.

Management of public enterprises is an important part of financial management in a developing country. Problems arise when the subsidy element threatens the financial position of a public enterprise. I am happy to note that the adjustment program in Mauritania covers the restructuring of the public enterprise sector.

Finally, the staff representative's report on the recent unfortunate developments in Mauritania is a matter of regret for all of us. These developments threaten the successful implementation of structural adjustment programs; they damage both the countries involved, but the smaller economy naturally feels the greater pinch in such a situation.

Mrs. Hansen made the following statement:

As the staff documents indicate, Mauritania has made some notable progress in a number of areas under its two arrangements under the structural adjustment facility, upon which we hope it will be successful in building under the proposed enhanced structural adjustment arrangement. Notwithstanding some slippage in 1988, the overall consolidated central government deficit has declined dramatically since 1985; the rate of consumer price increases has been cut approximately in half from 1985 to 1988; and the current account deficit also has shown improvement over that period. It is regrettable, however, that despite its numerous achievements, Mauritania has not achieved higher growth. In fact, economic growth has fallen noticeably short of program expectations.

Broadly speaking, we support the program objectives, and we agree with the staff's analysis of Mauritania's situation and the policy prescription it has advised, so I will not dwell on the specific features of the arrangement. I would like to stress, however, the particular importance we attach to appropriate pricing policies with regard to domestic prices, interest rates, and the exchange rate. In order for Mauritania to achieve its objectives, it is absolutely essential that prices

reflect resource scarcities, provide adequate incentives for savings and investment, and ensure the competitiveness of Mauritanian exports. This is key to eliciting the kind of supply response that Mauritania is depending upon for higher growth.

I would also like to commend the measures taken to improve external debt management and monitoring so as to restore normal relations with creditors. Such normalization will be important in helping to assure the availability of concessional financing, which Mauritania will need in coming years.

More generally, it is worth noting that the case of Mauritania provides a particularly striking illustration of the connection between structural reform and the achievement of macroeconomic objectives, and the corollary that the Fund needs to take a strong interest in both macroeconomic and structural elements of country programs. Despite markedly stronger macroeconomic policies, the remaining structural problems appear to have impeded economic growth and, according to staff reports, have contributed to weaknesses in the external position. For example, the Government's fiscal efforts have been hindered by the weakness of the mining company and its failure to pay taxes, as well as by the weakness in the banking sector and the difficulty of cashing checks to the Government written on Mauritanian banks. Similarly, investment and production were apparently hampered by delays in adopting and implementing a new customs tariff, investment code, and policies on cereals pricing and marketing, among other measures. Meanwhile, Mauritania's external position suffered from such structural problems as insufficient control of public sector enterprises and the heavy burden of administrative controls on private sector activity.

In light of this experience, we would urge the authorities to press ahead with the measures envisaged under the enhanced structural adjustment arrangement, giving particular attention to the timely implementation of structural measures. Special priority needs to be given to reform of the banking sector and public enterprises. In this regard, we believe the interests of program implementation would have been better served if this third policy framework paper for Mauritania had not been so broad and so lacking in explicit performance benchmarks; a number of the "actions to be taken" are general statements of intent rather than specific measures with identifiable target dates. In view of the Government's institutional weaknesses and the implementation difficulties experienced during the last two years, a more specific sequence of measures and timetables for reform would have been desirable.

Program monitoring will be very important, especially in light of Mauritania's poor track record in complying with the structural benchmarks under the structural adjustment facility. We note that most of the structural benchmarks under the proposed enhanced structural adjustment facility arrangement are to be completed by next month. As this is quite a short time frame, we trust that the measures are already well on track. We also expect that Fund staff will ensure at the time of the six-month review that the agreed measures have been taken.

We have some concern that slippages in program implementation hardly seem to justify the higher access that will be accorded under the enhanced structural adjustment facility. Of the ten policy measures identified as benchmarks under the second structural adjustment arrangement, it appears that only one was implemented on time, one was partially implemented, and eight were delayed. If Mauritania had continued with a third structural adjustment arrangement, it would have received considerably less access than the 50 percent of quota under the proposed first-year enhanced structural adjustment arrangement. In the circumstances, we would have preferred the latter arrangement to be back-loaded, with relatively less access in the first year, until we could be certain that program implementation had improved. Since this has not been done, an alternative approach would be to reduce second-year access below the proposed 50 percent of quota if implementation under the first-year arrangement is found to be wanting.

With respect to the timeliness of program implementation, we are also concerned that the recent unrest in Mauritania and neighboring areas may adversely affect the public and private sectors' ability to carry out their functions as envisioned under the program. Obviously, it will be important for the Fund and Bank to monitor the situation very carefully and assess its impact on the program. We would request that the staff report back to the Board as soon as it has a better appreciation of the impact of recent developments on the day-to-day operations and capabilities of government ministries, public enterprises, and private sector.

Mr. Jones made the following statement:

It is clear that even before the recent difficulties, the authorities faced a monumental task in implementing an adjustment program capable of correcting their external position and creating the framework for sustainable growth. Greater concessional financing would be of assistance in this context. Given the scope of the problems involved, the larger and longer-term resources available under the enhanced structural adjustment facility would seem appropriate. However, it is a requirement

for access to the enhanced structural adjustment facility that there be strong policies and that adjustment measures be implemented in a timely fashion, usually with considerable front-loading.

As mentioned in the operational guidelines to be followed by the staff in implementing the enhanced structural adjustment facility (SM/88/148, 7/12/88), there may need to be greater use of prior actions in certain cases, and studies are not an acceptable substitute for actions. Bearing this in mind, the slippages from Mauritania's structural adjustment facility program must give cause for concern about the arrangement proposed to replace it. Table 3 in the staff report is a catalogue of benchmarks missed or only partially achieved. The influences behind these slippages offer little comfort; in particular, I note that the failure to achieve external current account targets was due in part to expansionary credit policies and in part to slippages in structural reform progress, the latter stemming from delays both in completing the necessary studies and in obtaining consensus within the Government.

There are admittedly some bright spots, including an improvement in government finances and a narrowing of the resource gap. And yet growth deteriorated from 1987 to 1988 compared with the targeted level, despite large gains in the agricultural sector. There must, therefore, be some question whether Mauritania is yet ready for an arrangement.

The end targets of the proposed arrangement under the enhanced structural adjustment facility can be considered either in relation to recent actual experience or in relation to the existing targets under the structural adjustment facility arrangement. By the latter test, the projected achievements in 1989-90 are weak: growth is lower, inflation is higher, the current account deficit is wider, outstanding debt grows in relation to GDP, and the debt service ratio is not improved. Nor does this reflect increased investment or a higher projected level of reserves. Using the alternative basis of comparison--that is, comparing projections with recent actual experience--things look somewhat brighter, with accelerating growth accompanied by decelerating inflation, an improved current account, with declining debt and debt service, and a buildup in reserves.

This request for conversion to an enhanced structural adjustment arrangement is reportedly in order to allow for a stronger foreign reserve position while carrying out the adjustment effort. This chair has previously expressed concern that in too many cases this might be the only achievement of an enhanced structural adjustment arrangement, and it needs to be demonstrated that without such a reserve buildup, the whole

adjustment process might falter. Given the external position of the Mauritanian economy, this may well be the case, but I am not sure that it has been sufficiently clearly demonstrated.

I can go along with the approval of this enhanced structural adjustment facility arrangement despite the long-term persistence of significant financing gaps, since the staff is confident--or at least was before the recent social disturbance--that after the expiration of the three-year arrangement Mauritania will be in a position to maintain orderly relations with its external creditors. But I would have been happier if the track record had been stronger, and I have considerable sympathy with the suggestions made by Mrs. Hansen.

That said, I have only a few detailed comments. First, I note that all the objectives depend heavily on government initiatives. Given the authorities' record in such matters, I join other Directors in wondering if the provision of technical assistance, both by bilateral donors and the multilateral institutions, will not be as important as, or more important than, any other means of support.

Second, I welcome the authorities' commitment to freer trade and a flexible exchange rate policy. But in many respects, Mauritania is an open country by virtue of its permeable borders. I wonder whether harmonization of sectoral policies across borders is not an external aspect to which the authorities should pay close attention. In this context, I very much welcome the policy framework paper's discussion of regional cooperation regarding the environment.

Third, I note that the authorities have already taken actions in order to achieve the objectives of the 1989 program. Their chances of success have been affected by recent social disturbances, but I find this evidence of commitment reassuring.

I would recall that the Board has recently extended the period of availability for enhanced structural adjustment facility resources, which would allow potential applicants greater time in which to achieve the domestic consensus necessary to commit themselves to establishing the track record or the prior actions that would be assessed in considering an enhanced structural adjustment facility arrangement. The Fund need not be embarrassed about a slow take-up of enhanced structural adjustment facility resources. The Fund's record with enhanced structural adjustment arrangements so far has been good. I very much hope the authorities can now demonstrate the necessary commitment so as to maintain that record.

Mr. Morita made the following statement:

At this stage of the Board discussion, I will be brief. We generally believe that the policy framework paper under the enhanced structural adjustment arrangement before us is appropriate. This policy framework paper is broadly the continuation of the last policy framework paper under the structural adjustment facility arrangement, but the emphasis of the paper before us seems to be placed more clearly upon the macroeconomic adjustments need through wide-ranging structural measures with a more realistic growth objective, which we believe is appropriate in the current circumstances.

As far as the specific policies are concerned, we generally support the staff's analysis and appraisal, but I would emphasize here the need to promote private economic activities, especially in the export sector. This effort is expected to be supported by public sector restructuring, liberalization of various restrictions of the markets, and flexible exchange rate policy. Such measures should be vigorously implemented, and would be more effective if implemented under the appropriate framework of industrial policy.

The background paper points out the sensitivity of the external prospects to the performance of a few major exports, namely, iron ore and fish. The staff also notes that in the event of a fall in these export earnings there would be a need for faster domestic adjustment. We support the staff's view and consider it advisable that the staff discuss with the authorities well in advance the specific measures to be additionally taken or to be front-loaded in that unfortunate event. We recognize that the necessary corrective measures would vary depending upon the magnitude of the shortfall in export earnings. Nevertheless, we would appreciate it if future staff papers could be as specific as possible in this regard. Because the authorities have already made a good effort to develop a comprehensive program, negotiation on further strengthening the adjustment efforts might be time consuming. In addition, macroeconomic performance appears to be closely linked to the pace and magnitude of the structural measures in this case. Because of the sensitivity of the external sector, any windfall gains from unexpected export earnings should be used to build up reserves, as the targeted level of reserves seems low.

Finally, in light of Mauritania's fragile economic situation, we should like to emphasize our preference for the midterm review to take place in the Board and not on a lapse of time basis, and we look forward to that discussion. We can support the proposed decision.

Mr. Morshed made the following statement:

Since 1985, the authorities have been pursuing a difficult and comprehensive Fund-supported adjustment process directed toward arresting internal and external economic imbalances while promoting growth. The extent of macroeconomic adjustment achieved is demonstrated by the narrowing of the consolidated central government deficit excluding grants, from 15 percent of GDP in 1985 to an estimated 6 percent in 1988. The authorities have also maintained a flexible exchange rate policy, and they have followed a policy of credit restraint and maintained real positive interest rates on key deposits.

Furthermore, structural measures relating to private sector collection, processing and marketing of rice, the sale of rice mills to the private sector, the preservation of fish resources, and the new investment code are also a reflection of the authorities' determination to pursue reform aimed at improving the efficiency of resource allocation and enhancing social welfare. Delays in the implementation of certain structural measures so as to generate a consensus within the Government on the need for reform are understandable. Without such a consensus, successful implementation may not be possible.

It is necessary to note that, despite the measures adopted, GDP growth has been below 3 percent in three of the last four years, while the population has been growing by 2.6 percent a year. The current account deficit excluding grants is still about 18 percent of GDP compared with 26 percent three years ago. To some extent, depreciating terms of trade and delays in the implementation of certain envisaged structural measures are the cause of the slow growth and persistence of the wide current account deficit. The authorities' resolve in persevering with the adjustment process, as outlined by Mr. Mawakani in his statement, is commendable.

As I am in broad agreement with the thrust of the staff appraisal, and as I support the proposed decision relating to use of enhanced structural adjustment facility resources, I will briefly make some specific observations.

First, the need to prioritize public investment so as to improve resource utilization cannot be challenged. However, caution is needed in the scaling down of the public investment program. Public investment is often a necessary prerequisite to improved physical and social infrastructure, which in turn can lead to an increase in the absorptive capacity of the economy. I also hope the authorities will continue to monitor the overall level of investment and the incentive structure within the economy so as to ensure that increased private sector activity compensates for the less ambitious public investment targets.

Second, the link between trade liberalization and reduction in the external imbalances of low-income developing countries is uncertain, especially in terms of the timing and sequencing of measures. In this context, a more gradual approach toward the reduction of effective tariff rates might be appropriate as such a measure may be accompanied by a short-term deterioration in the trade balance. The issues involved in this area are complex and, in this connection, I look forward to the forthcoming discussion on conditionality.

Third, we particularly welcome the fact that measures are being taken to alleviate the impact of the program on the most disadvantaged sections of society. Over time, and with improvements in data availability, I hope it will be possible to include in the staff report more quantifiable measures of social support. For example, the expenditure targeted at poor sections of society could be compared to the envisaged reduction in public spending, or to increased revenue collection from measures which affect public consumption.

Finally, I wish to note that the substantial efforts of the Government deserve the support of the international community through increased assistance and debt relief.

Mr. El Kogali said that he had little to add to Mr. Mawakani's statement. He very much welcomed the fact that Mauritania, as one of the African countries, was joining the enhanced structural adjustment facility club. Mauritania was a case to be considered with attention; it was a poor country, which needed more than Bank and Fund resources. The Fund should also mobilize funds from the international community through its good offices and catalytic capacity.

Mauritania's situation should not be viewed only from the balance of payments perspective, Mr. El Kogali remarked. For example, he would consider it appropriate to place more emphasis on education in Mauritania. He hoped that, with the help of the Fund and the Bank, a new large university could be established in Mauritania to begin doing essential work on the Muslim and Arabic books and manuscripts that were stored in the country. In that connection, could the staff explain why only $4.99 million of the $23 million that had been allotted for education under assistance from the International Development Association had been disbursed?

Mr. Hogeweg said that he very much appreciated Mr. Mawakani's statement that, in spite of the regrettable conflict with Senegal, the authorities were still fully committed to their adjustment effort. They certainly deserve the Fund's support. However, in the Bank discussion on the policy framework paper, several Directors, including his counterpart, had expressed concern about the authorities' ability--as opposed, of course, to their commitment--to implement the program fully under the

circumstances. He understood from paragraph 3 of the Managing Director's statement that the World Bank would send a mission to Mauritania to assess the implications of the conflict and possible needed modifications. The statement by the Fund staff recognized the uncertainties, making reference to close monitoring of developments and the midterm review in September, but it was at the same time reasonably confident. Perhaps the staff could comment on the relationship between the two statements; was the Bank mission somehow related to the midterm review? It was very important that the two institutions move in parallel in such matters. Both administrative capacity and a political environment conducive to tough but necessary reforms were very necessary for the program to be a success.

The staff representative from the African Department recalled that a number of questions had been asked about the consensus that might exist in Mauritania to move ahead with the reforms. In that connection, discussion on the program currently before the Board had begun in June 1988, and had been resumed in November 1988. In the interim, the Government had had time to engage in consultations domestically, to ensure that there was support for a program supported by the enhanced structural adjustment facility. Since the discussions on the program had been concluded at Fund headquarters only in February, nine months of discussions, consultation, and consensus-building had led to the paper that was currently before the Board.

There had been a great deal of discussion in Mauritania, and the Government had taken a major part in drafting the policy framework paper itself, the staff representative indicated. Accordingly, the staff was fairly confident that the necessary consensus existed in Mauritania to move ahead with the program. An example of the Government's determination was the fact that the Government had already taken a number of difficult measures, as set out on page 25 of EBS/89/83, including an additional devaluation of the exchange rate of the ouguiya on April 2, 1989. A number of liberalization measures in the trade sector, including elimination of the requirement to issue import licensing, had been implemented, and the importer/exporter card had been liberalized. All those actions had been taken much earlier than one would have expected had there not been a consensus in Mauritania to move ahead with the program. In addition, the staff's statement outlined further measures recently taken by the Government. In response to the unexpected and difficult social situation that had developed, the Government had mobilized voluntary support in Mauritania and independently had decided to reduce the budgetary allocation set out in the program by about 5 percent, earmarking those resources to deal with the new situation. All those steps were heartening.

In response to questions about whether there were sufficient prior actions by the authorities and whether reform measures were ambitious enough to justify a program supported by enhanced structural adjustment facility resources, given the mixed track record of Mauritania, the staff representative said that the authorities had already undertaken significant measures since January 1989. The 1989 budget included a major reform

of the tariff system, implementation of an investment code, and some fiscal reforms, including reform of the direct taxation of business profits. Such efforts augured well for the Government's ability to undertake the arrangements under the extended structural adjustment facility.

As far as the Government's capacity to implement ambitious structural reform measures was concerned, the staff representative continued, the authorities were aware of the need to obtain technical assistance from the Fund and the Bank in order to move ahead in some of those areas. In particular, they had already approached the Fund to request technical assistance to put into effect the second phase of the fiscal reform, which was supposed to take place in 1990. The authorities had also recently requested assistance from the Fund to study new credit control instruments, which would also be implemented in 1990. In addition, the authorities had been discussing with the Bank reforms to enhance institution building in Mauritania. The Government appeared to be cognizant of its administrative limitations, making use of Fund and Bank assistance when necessary to avoid delayed structural reform.

On the education sector, the three-year education program had become effective in August 1988, with some cofinancing by the African Development Bank, the staff representative indicated. He expected that the disbursement of the associated IDA loans could be accelerated in the coming months.

The Fund staff had been in consultation with the Bank staff and was also in contact with the Government, in order to follow the recent developments in Mauritania, the staff representative from the African Department said. Currently, the situation was still delicate, and that had to be taken into account in determining when the Bank and the Fund missions should take place.

The staff representative from the Exchange and Trade Relations Department recalled that the issue of a country's record of program implementation had been highlighted in the last review of the enhanced structural adjustment facility at the end of March 1989. At that time, Directors had concluded that where the measures had not been implemented under the previous arrangement, the appropriate response would be to require corrective measures as a prior action to the following arrangement, either in the particular area where the implementation was not satisfactory, or in other areas to compensate for the slippage observed. It was not suggested that the country's record of implementation should affect judgment on access. Rather, access was to be determined on the basis of the strengths of the proposed program, as well as on the financing need.

In the case of Mauritania, as described on page 25 of the staff report, a number of prior actions offered confidence that the difficulties experienced under the previous arrangements had been satisfactorily overcome, the staff representative commented. There had been problems

specifically in the area of debt service payments. As he understood it, a set of administrative measures had been adopted as a prior action, and as a result the debt service payments had been made on time since December 1988. All debt that was not to be rescheduled had been repaid on time.

Executive Directors would have the opportunity to review the program in six months, at which time they could propose prior action in the context of the following annual arrangement if they considered that the implementation record was not satisfactory, the staff representative noted. He would consider such an approach preferable to reducing access in the first year of the arrangement.

As far as the access level was concerned, the staff representative said, the operational guidelines for implementation of the enhanced structural adjustment facility (SM/88/148, 7/12/88) clearly stated that a majority of enhanced structural adjustment facility arrangements would involve three-year access of about 140-160 percent of quota, and that access beyond that could be contemplated for programs that envisaged measures with high foreign exchange costs, such as trade liberalization. Since the Mauritanian program highlighted trade liberalization, the access level proposed seemed to be consistent with the guidelines established by the Board.

The staff representative from the World Bank commented that the Bank had been offering Mauritania a considerable amount of support for strengthening development management; currently, two projects were being implemented. The most recent was a development management project, which was designed to strengthen the functioning of the Ministry of Economy and Finance, in particular, in areas of investment programming and project appraisal, and also in such areas as the administration of personnel and the estimation of recurrent expenditures and of the personnel size required. That project had itself taken quite a while to become effective--a symptom of a weak implementation capacity. The Bank had also, like the Fund, experienced slippages in its project.

The bulk of technical assistance to Mauritania was in the public enterprise sector, where the Bank had been working for a number of years on a series of reforms in individual public enterprises, as well as on a few measures designed to cut across public enterprises, the staff representative indicated. The benefits of those reforms were being seen primarily in the utilities sector. The project had also contributed to the preparation of a major reform program for public enterprises, which the World Bank was shortly to appraise, and which would involve a more fundamental restructuring. The first public enterprise operation had, essentially, been seen as technical assistance only, and had not dealt with the financial restructuring of public enterprises, as the follow-up operation would.

With regard to the education sector, the information provided by the Fund staff regarding the delay in the effectiveness of the project fully reflected the difficulties that had been encountered with the project's implementation, the staff representative from the World Bank said. The project was intended to lead to a fairly major restructuring of the education system, shifting resources into basic education, and would result in the rationalization of expenditures at the higher levels of education and some stabilization in the level of education and some stabilization at the level of scholarships for secondary education.

Mrs. Hansen said that she would be the first to agree that a number of factors would have to be taken into account when one decided on the level of access. She certainly hoped that the midterm review would indicate that the Fund had, indeed, shown good judgment in that case. However, one also had to keep in mind what kind of signal was being sent to the membership and, indeed, to the international community at large if it appeared that previous performance was not fully reflected in the access limits. In addition, the Fund might not be doing the country any service if the country was encouraged to increase its obligations to the Fund without being certain that its ability to repay the Fund would also be increased.

Granted, the enhanced structural adjustment facility program was intended to be strong, Mrs. Hansen agreed, but the fact remained that owing to implementation problems under the structural adjustment facility, growth had been a good deal lower than expected, which indicated that Mauritania's ability to meet its external obligations, including those to the Fund, was less than would have been hoped. In addition, enhanced structural adjustment facility resources were finite. Perhaps Mauritania's interests would be better served if it had an extra year under the structural adjustment facility to put it in a still better position to take advantage of enhanced structural adjustment facility resources for the following three-year period.

Mr. Nimatallah remarked that the access being proposed was reasonable in light of Mauritania's performance.

Mr. Hubloue said that, as he understood it, Mrs. Hansen was proposing to curtail access in the second year when policy performance under the first year was not appropriate. In that context, he would fully support the staff's view that prior actions would take care of such concerns. When policy implementation was weak in the first year, then it should eventually be corrected by the prior actions. Access should not be curtailed at the outset of the second year, because that would send the wrong signal to the international community and the country concerned; in order for a country to implement its policies, it needed substantial access to resources from the international donor community.

Mr. Mawakani said that he agreed with the staff on the steps that the authorities had taken before concluding discussions with the Fund. In addition, the Minister of Finance and the Governor had come to Washington

to finalize the discussion with the World Bank and to conduct talks with the Fund in the context of that program. He could therefore reaffirm that the necessary consensus existed on the authorities' part to implement a program under the enhanced structural adjustment facility. The authorities had been committed to the adjustment programs since 1985, and they would continue to be so.

On access to enhanced structural adjustment facility resources, Mr. Mawakani said that he fully agreed with Mr. Nimatallah and Mr. Hubloue on the appropriateness of the proposed access for Mauritania. There would be an opportunity, at the time of the review, for a further update on the implementation of the program.

The Acting Chairman remarked, on the relationship between performance and the financing commitment, that there might be cases in which the resources that would be made available could be reduced until the country was ready to make the adjustment. For example, if the level of access had been related to expectations about the implementation of trade liberalization measures that would increase the resource requirements of the country, and those structural measures were delayed, a reduction in access would be appropriate. The access provided some confidence to the authorities that they could proceed with trade liberalization without facing an excessively tight external position.

The Acting Chairman made the following summing up:

> Executive Directors were in broad agreement with the appraisal in the staff report on the 1989 Article IV consultation with Mauritania. Directors indicated that Mauritania's adjustment efforts since 1985 had contributed to a significant reduction in financial imbalances and to some improvement in the rate of economic growth, although disappointment was expressed in the fact that the rate of growth had not been more responsive. Directors stressed, however, that the financial situation of Mauritania remained fragile, as indicated by the persistent accumulation of external payments arrears, and as a result of slippages in implementation of the structural reforms needed to strengthen the external position and improve the fiscal situation and overall performance of the economy.
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> Directors commended the Government's decision to continue its adjustment and structural reform program over the medium term, as outlined in the policy framework paper for the 1989-91 period. They supported the authorities' objective of containing aggregate demand and reducing government control over economic activities, through the liberalization of the pricing system and trade regime, while providing incentives for private sector investment production and exports. Directors welcomed the far-reaching structural reforms that were being implemented to strengthen the agricultural and fisheries sectors and to rehabilitate the public enterprise sector through divestiture,

liquidation, and increased private sector participation. The effective implementation of those reforms was seen as a key to the attainment of Mauritania's medium-term objectives. The correct sequencing of the reforms was seen as particularly important and, in that connection, concern was expressed regarding Mauritania's limited administrative implementation capacity.

Directors attached considerable importance to the authorities' commitment to the implementation of a flexible exchange rate policy and a fiscal policy aimed at reducing the overall deficit in central government operations, together with a prudent monetary policy, including a policy of maintaining interest rates that were positive in real terms. Those policies were considered essential for encouraging domestic savings, lowering inflationary pressures, achieving the Government's balance of payments objectives, and attaining a more efficient allocation of resources. However, most speakers were of the view that Mauritania should improve its track record of implementation of macroeconomic policies and structural reforms.

In assessing the authorities' program for 1989, Directors commended the Government for reducing administrative price controls and eliminating import licensing. The new investment and tariff codes were welcomed. Directors agreed with the Government's decisions to reduce the overall consolidated deficit in central government operations, and to maintain a prudent monetary and credit policy by reducing the banking system's claims on the Government; they also concurred with the steps that were being taken to restructure the banking system, in particular those to reduce the level of nonperforming loans. While noting the reforms of direct taxation that were being put in place, Directors also urged the authorities to complete the studies required to implement a more efficient and elastic tax system. On the expenditure side, Directors expressed support for the measures adopted by the authorities to contain current outlays--in particular, the wage bill--as well as subsidies and transfers. However, the authorities' efforts to reduce subsidies and transfers should take into account the need to protect the lower-income groups.

Directors were of the view that Mauritania's policies continued to deserve the support of the international community, particularly in the form of grants and concessional assistance. Fund technical assistance and, indeed, technical assistance from other sources were also seen as desirable to improve the economic database and strengthen external debt management, as well as to strengthen the administration and implementation of the program.

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

The Executive Directors then took the following decisions:

Decision Concluding the 1989 Article XIV Consultation

1. The Fund takes this decision in concluding the 1989 Article XIV consultation with Mauritania, in the light of the 1989 Article IV consultation with Mauritania conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Mauritania maintains the restrictive exchange measures described in EBS/89/83 in accordance with Article XIV, Section 2, and none of these measures is subject to approval under Article VIII.

Decision No. 9158-(89/63), adopted
May 24, 1989

Enhanced Structural Adjustment Arrangement

1. The Government of Mauritania has requested a three-year structural adjustment arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund has appraised the progress in implementing the policies and reaching the objectives of the program supported by the first annual arrangement and notes the updated policy framework paper for Mauritania set forth in EBD/89/116.

3. The Fund approves the arrangements set forth in EBS/89/83, Supplement 2.

Decision No. 9159-(89/63), adopted
May 24, 1989

2. TUNISIA - 1989 ARTICLE IV CONSULTATION, AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1989 Article IV consultation and review under the extended arrangement (EBS/89/58, 3/28/89; and Cor. 1, 5/17/89), together with a statistical appendix (SM/89/71, 4/19/89).

The staff representative from the African Department indicated that the staff had just received additional preliminary information on recent macroeconomic developments in Tunisia. Although the overall performance remained good, the level of net foreign assets of the Central Bank at end-March 1989 had declined to about SDR 301 million, or some SDR 65 million below the floor set in the program. The reasons for that shortfall were not entirely clear, but they might be related in part to temporary factors. In April, there had been a partial recovery in external reserves. The staff remained in close touch with the authorities, who had assured the staff that they were examining the situation with a view to returning to the program's targets.

Mr. Ghasimi made the following statement:

Since the last review by the Executive Board, the Tunisian economy has continued to perform satisfactorily, in particular with regard to the external financial position, which recorded a surplus in the current account. This contrasts with a slowdown in economic growth and the less than expected fiscal performance--developments that were adversely influenced by severe exogenous factors, including a prolonged drought and a devastating locust invasion. Overall, real GDP growth reached only 1.5 percent in 1988 compared with 5.8 percent in 1987.

The impact of the exogenous factors was particularly pronounced in the agricultural sector, which showed a decline of 24 percent in output following the realization of a cereal crop in 1988 representing only 15 percent of the 1987 level. This development, combined with higher cereal import prices, led the authorities to augment cereal imports in 1988 by an equivalent of 121 percent of Tunisia's quota in the Fund. As a result, total imports increased by 19.5 percent in 1988 compared with a programmed rate of 10.2 percent and a decline of 5.5 percent in 1987.

The export sector, on the other hand, continued to perform well despite the continuous decline in oil exports. Led by a strong performance of nonenergy products, total exports increased by 7.8 percent, whereas the program target aimed for an increase of only 1.1 percent. My Tunisian authorities believe that the satisfactory export performance is the result not only of external factors but, more important, reflects the improvement in competitiveness, as well as the continuous

efforts in diversification and reorientation of the economy toward the expansion of manufactured exports. In this respect, Directors may note that, on the occasion of the last world economic outlook exercise, Tunisia was reclassified among the group of exporters of manufactured goods because the share of its nonfuel exports has increased to more than 50 percent of total exports.

With regard to tourism, which remains the main source of exchange earnings, a remarkable expansion was recorded during 1988 with total receipts increasing by 77 percent.

These positive developments were reflected in a considerable adjustment of the external financial position of the economy, with the current account of the balance of payments moving to a small surplus compared with a deficit of 3.8 percent of GDP originally anticipated in the program. The authorities proceeded for the second consecutive year to build up international reserves, which were augmented by 79 percent in 1988 to the equivalent of 3.1 months of imports, a level that reflected the authorities' cautious approach in light of the vulnerability of the economy to exogenous factors.

On the fiscal side, the impact of higher cereal imports, as well as increased spending on economic aid and development projects designed to alleviate the adverse consequences of the drought in rural areas, induced larger than projected public expenditures. The authorities were able to offset part of the expenditures overrun through higher revenues and increased savings on some current expenditures, as well as on lending operations to public enterprises. As a result, the consolidated central government deficit reached 4.3 percent of GDP, exceeding slightly the programmed level of 4.1 percent of GDP. The authorities took advantage of the rise in international reserves to reduce drawings on some external borrowing and to finance a larger part of the budget deficit through nonbank domestic sources.

Regarding structural measures, the implementation of policy reforms proceeded according to the timetable specified in the program and summarized in Appendix IV of the staff report. The measures implemented in 1988 included additional price and import liberalization, the introduction of a value-added tax, and further progress in the area of public enterprise restructuring. Significant progress has also been achieved in deregulating the banking system and in strengthening the money market. The latter reforms, which are described in SM/89/71, will be further reinforced by drawing on the recommendations of two studies, conducted in collaboration with the Fund's Central Banking Department, on the introduction in the money market of treasury bills and the improvement of interbank competition.

My Tunisian authorities would like to take the opportunity of the first program review to reiterate their commitment to the medium-term adjustment strategy. They point out that while they are definitely encouraged by the gains achieved under the previous stand-by arrangement and by the better than programmed performance during the first year of the extended arrangement, they also recognize the rather fragile nature of the economy, particularly with regard to external factors. They have emphasized their concerns about the sluggishness of domestic demand, particularly investment, and about the critical problem of high unemployment, which was aggravated in 1988 by the prolonged drought.

In reviewing the program for 1989 and beyond, the authorities have managed to strike a delicate balance between the need to achieve early balance of payments viability, on the one hand, and to sustain increased growth and employment, on the other. To this end, and in order to capitalize on the better than expected performance of the external sector, they strengthened the program objectives by planning a faster reduction in the current account deficit, and by adjusting upward the reserves targets. Concomitantly, and in order to accommodate a faster rate of growth by the end of the program period, they also proceeded to readjust the level of investment, which is expected to pick up following a much more favorable economic environment.

Preliminary indications for the first quarter of 1989 confirm that cereal crop for 1989 will be depressed owing to the continuation of adverse weather. Consequently, the growth rate may well be lower than the projected 5.1 percent. This development, combined with a surge in imports, could exert additional pressures on the current account, which is programmed to reach a deficit of 1.5 percent of GDP by the end of 1989. The authorities are comforted, however, by the fact that the recent rise in imports is being partly reflected in the acquisition of capital goods, an indication of the rebound of private investment in line with the increase in the intentions to invest witnessed in 1988. In the same vein, they are also encouraged by the continued growth of earnings in the tourism sector.

In order to accommodate growth and balance of payments targets and to contain inflation, the authorities will pursue the implementation of appropriate macroeconomic policies. In this respect, the budget deficit is forecast to decline from 4.3 percent of GDP in 1988 to 3.9 percent of GDP in 1989. Concomitantly, a rather tight monetary stance is being adopted so as to dampen the inflationary pressures arising from the excess liquidity accumulated in 1988.

With regard to structural measures, the authorities will proceed with the implementation of the next phases of price and import liberalization. They are also undertaking a review of the Subsidy Fund, with the objective of streamlining, as far as possible, its operations and targeting its recipients to the most vulnerable income groups. Public enterprises will receive a further impetus with the completion of a public enterprise restructuring loan with the World Bank in 1989. On the fiscal side, the authorities will reinforce the reform process by introducing in 1989 personal and corporate income taxes. Needless to say, the opening up of the economy will proceed during the program period. Recently, the authorities granted a deposit money bank license to a foreign-owned bank in order to foster interbank competition. Furthermore, and in line with the authorities' firm intention to encourage foreign investment, a new investment code in the services sector will be adopted shortly. The new code will complement the highly favorable incentives to foreign participation that are already embodied in the legislation introduced in the areas of industrial and tourism investment.

Finally, my Tunisian authorities continue to consider regular reviews of their adjustment program by the Executive Board constructive and quite helpful. They believe that tighter monitoring is an important and essential element in assessing the adherence to the objectives of the medium-term adjustment program and, therefore, they continue their preference for maintaining quarterly performance criteria.

Extending his remarks, Mr. Ghasimi indicated that the authorities had taken a further step toward more flexibility in the conduct of monetary policy, in line with the recommendations of the Central Banking Department during its technical assistance mission. The new measures introduced one week previously had been designed to streamline the financing of priority sectors as well as the operations in the money market. In that regard, the reserve requirement had been extended to all banks, whereas previously only commercial banks had been affected. Furthermore, the level of reserve requirement had been raised from 0 to 2 percent, and the Central Bank of Tunisia had modified the characteristics of commercial paper that could be issued by enterprises with access to the money market. The main improvements designed to increase the use of commercial paper and consequently to enhance the mobilization of resources were the reduction of the minimum denomination from D 500,000 to D 100,000, and the lengthening of the term from 180 days to five years. His authorities also wished to inform the Board that the price liberalization initially programmed for end of March 1989, which coincided with the beginning of Ramadan, had been postponed to June 1989.

He would draw Directors' attention to the fact that Tunisia had not made any purchases under the extended arrangement in 1988, Mr. Ghasimi said. Despite the heavy pressures on the balance of payments arising from the continuous increase in cereal imports during the first quarter of 1989, the authorities did not intend to use Fund resources for the time being, unless there were unforeseen developments. That issue would be further considered by his authorities on the occasion of the next program review.

Mr. Nimatallah made the following statement:

I view the Tunisian case under three headings: performance, problems, and recommended solutions.

Under performance, one needs to look at the authorities' commitment, the specific performance criteria, and general management of the economy. On commitment, I am convinced that the authorities' resolve to continue reforms and accelerate growth is beyond doubt. On the performance criteria, I do not see much to worry about except inflation, but even that is not worse than the performance of certain industrial countries. On management, I think the economy is being well managed, and the program is in good hands. The proof is in the flexible way that the authorities responded when they were faced with three unpleasant problems beyond their control, namely, drought, locust invasion, and higher international cereal prices. These factors could have put the program off track in some other countries, but the Tunisian authorities handled them very skillfully indeed, without even purchasing any resources from the Fund under the arrangement.

Now, what problems does one see in the economy of Tunisia? The staff and the authorities point at lower than expected domestic and foreign private investment, on the one hand, and a higher than expected unemployment rate, on the other. On investment, the staff seems to point at the still insufficient degree of the liberalization of the economy, but I, for one, think that the authorities are moving steadily forward in removing rigidities. For example, imports grew by 16 percent in 1988. It seems to me that what is needed is more time for both the authorities, as they continue their reform efforts, and the investors, as they gradually become convinced that Tunisia means business. I know that investors from the Gulf want to see less red tape to facilitate their entry to the market, reasonable labor costs, and no restrictions against transfer of their profits.

Therefore, the advice that the Fund should offer is continuity and persistence in reform efforts. The authorities need to persevere in their efforts, as I believe it is just a matter of time until investors gain confidence in the Tunisian economy so

that the flow of private capital can resume. It is natural that private investment is now directed mostly to the export sector, because wise investors usually look for sizable markets first. As the domestic market strengthens, and its effective demand increases, I am sure that investors will seek investment opportunities beyond the export sector.

As far as unemployment is concerned, I think that the authorities are right that, again, with time and as growth is sustained at higher rates, high unemployment rates will gradually subside. After all, this is a typical problem that most members of this organization suffer from, and it is clear now that its solution comes with time as progress is made on structural reform and real growth. I endorse the proposed decisions, and wish the authorities well.

Mr. Marcel made the following statement:

We are pleased to note the continuing improvement in Tunisia's economic situation and the fact that, despite adverse exogenous factors--drought and invasion by locusts--the objectives of the program were surpassed. We are particularly impressed by the excellent performance registered in the external sector. Indeed, the external current account was in slight surplus in 1988, while the target for this year was a deficit of 3.8 percent. This was mainly due to high tourist receipts, and also to the strong performance of nontraditional exports. This remarkable achievement is attributable to the strong continued commitment of the authorities to adhere to the structural adjustment process.

Nevertheless, problems still lay ahead. As Mr. Ghasimi mentioned in his statement, the prospects for 1989 are not entirely positive. Growth might be lower than projected; inflationary pressures could increase; and there are risks that fiscal slippages could occur. In this context, there is no alternative for the authorities but to continue their adjustment efforts. We believe that the impressive success reached so far can only incite them to go on in this direction. Careful macroeconomic policies remain crucial. Indeed, they are, in our view, a prerequisite to achieving more sustained growth with balance of payments viability.

Fiscal policy has a key role to play in releasing more resources into the private sector. There is no room for complacency in this area; as the staff pointed out, excluding grants and exceptional transfers from government revenues, the fiscal deficit is likely to increase in 1989 and reach a sizable level. The authorities should take into account the likely nonrecurrent nature of their grants when considering the medium-term

fiscal outlook. Although I can understand that fiscal performance suffered from the effects of the drought, the authorities should be aware of the dangers of any further slippages during the whole adjustment process.

On the expenditure side, we encourage the authorities in their willingness to reassess their subsidy policy, in particular by focusing more on the most vulnerable income groups. I would appreciate further comments from Mr. Ghasimi on this point. I also agree that particular attention should be paid to the wage bill. Moreover, vigilance is also required on the revenue side. We welcome the important steps already taken with regard to the tax reform, and are particularly pleased to note that the introduction of the VAT has not brought about revenue losses as expected. We encourage the authorities to pursue this course by introducing personal and income tax reforms.

I note that the authorities felt strongly that a new tax measure would run counter to the reform process. I would be interested in having further comments from Mr. Ghasimi and the staff on this point. In any case, the tax reform must be monitored closely and the tax administration should be strengthened so as to lead to a recovery of the tax/GDP ratio.

Monetary policy must also be carefully monitored, in order to keep inflation under control. We welcome the far-reaching market-oriented measures already taken. However, we note that there was a rapid increase in money supply in 1988, leading to an excess of liquidity. In this context, we strongly encourage the authorities to be vigilant in formulating their interest rate policy. The inclusion of treasury bills is also most welcome and should contribute positively to a good implementation of monetary policy. Further liberalization of the financial sector should also help reduce intermediation costs.

Turning to the external sector, I would like to commend the authorities for the good results recorded, which are largely due to the flexible exchange rate policy followed since 1986. We cannot but encourage the authorities to pursue this policy. I concur with the staff that the authorities must be very careful in monitoring the new exchange rate guarantee scheme in order to avoid losses to the Central Bank.

On the medium-term balance of payments outlook, I share the staff's view, and can only stress the importance of attracting foreign investment. I would appreciate knowing whether the authorities envisage taking further measures in this area.

We thoroughly agree that Tunisia needs to achieve strong growth, in particular to absorb the rapidly growing population, and structural reform has a key role to play in this area. It is true that private investment has not yet fully responded to the new policy environment, especially in the domestic sector; this can only reinforce the need for the authorities to pursue liberalization and the opening of the economy, and even to accelerate the pace of the reforms.

The relaxing of price controls, along with a reduction in consumer subsidies and import liberalization measures, are of the utmost importance in stimulating private investment, especially in competitive activities. For these reasons, we are very pleased to note that the implementation of structural measures remained on track, but we share the staff's view that the buildup of reserves could enable the authorities to speed up the implementation of measures toward import liberalization. Furthermore, we encourage the authorities to pursue the reform of public enterprises.

The reduction in the level of unemployment is certainly one of the main challenges faced by Tunisia, and I share the authorities' concern on this point. In our view, however, this reinforces the need to pursue the structural adjustment process so as to promote growth and investment. I agree with the staff that the authorities should be careful not to provide too many incentives to capital-intensive production, which could have perverse effects on employment. I would appreciate Mr. Ghasimi's views on this point.

Finally, let me stress that the authorities have undertaken very courageous measures. My authorities have no doubts about their commitment to face the challenges ahead, and they fully support them in their endeavors.

Mr. Fayyad made the following statement:

The performance of the Tunisian economy under the extended arrangement has thus far been quite encouraging in several respects. Signs of the improved performance in 1988 were most evident in the external sector, largely on account of a near doubling in tourism receipts, but were also aided by a better than expected export performance, with the external current account registering a surplus of 0.2 percent of GDP compared with the program target of a 3.8 percent deficit. This occurred in spite of a sharp increase in imports as a result of the drought and the locust infestation. Moreover, while these

adverse exogenous developments have contributed to some slippage in the fiscal area, the picture that clearly emerges when one reviews overall developments and policies is that of adherence and full commitment to the charted adjustment course.

Like those adopted in 1988, the policies and adjustment measures that pertain to the 1989 program also reflect the authorities' determination to achieve their growth and adjustment objectives in the context of a sustained drive to modernize the productive system and open up the economy to foreign competition and greater private sector participation. As various elements of the program are thoroughly covered in the staff report, I shall limit myself to a few remarks.

First, the lackluster performance of fixed investment in the first year of the program is a source of particular concern, especially when one considers that it came on the heels of a substantial decline in the previous two years. Of course, to the extent that this has been a reflection of a cautious response on the part of the private sector regarding the change in policy direction, one would hope that the authorities' adherence to policies consistent with achieving greater private sector participation, both under the previous and current adjustment programs, would lead to adequate crowding-in of private investment. We are encouraged by the signs of an impending improvement in investment performance in 1989 and hope that this improvement will be sustained in the coming years. This would be essential to the achievement of growth rates sufficient to absorb new entrants in the labor force and address in a fundamental way the rather serious unemployment problem in Tunisia.

Second, the authorities' intention to grant moderate salary increases more frequently than in recent years, subject to constraints posed by budgetary and competitiveness considerations, is welcome, as such increases would obviate the need for the kind of increase that was granted last October and which, although understandable following four years of wage freeze, resulted in a sharp increase in the wage bill in 1989.

Third, one can understand the authorities' unfavorable disposition toward the introduction of additional tax measures at this juncture, and their concern about the adverse implications that that could entail for the reform process. In fact, it would seem that their strategy for achieving the targeted reduction in the fiscal deficit through a further compression of the expenditure-to-GDP ratio is more in line with the need to achieve the desired shift in the use of resources envisaged under the program.

Fourth, the authorities' reaffirmation of their commitment to proceed with the implementation of import liberalization as scheduled is welcome. And while, as noted by the staff, the better than expected performance in the external sector would appear to allow an acceleration of import liberalization, the largely exceptional nature of the overperformance and the high vulnerability of the external sector to adverse exogenous developments would argue in favor of the authorities' approach. It is to be noted in this regard that the staff's main medium-term scenario allows for only moderately higher imports than initially foreseen in support of the investment effort and liberalization process, and that their sensitivity analysis suggests that small increases in the growth rate of imports could yield quite a significant deterioration in the external current account.

Finally, we share the authorities' concern regarding the vulnerability of the economy to adverse exogenous developments, but we are encouraged by the adjustment gains they have been able to achieve and consider that their strong adjustment effort and commitment to the medium-term strategy, as reaffirmed in Mr. Ghasimi's statement, merit the Fund's full support.

Mr. Fernández Ordóñez remarked that a number of external developments in 1988 had determined Tunisia's economic performance in that year. The drought had had a large negative impact on agricultural production and had led to increased imports, but the relatively good behavior of its customers had helped Tunisia to realize a notable increase in exports. Nevertheless, the success in exports could not be explained only by external factors, but was also caused by the improvement in competitiveness and by other economic policies implemented by the authorities.

He supported the proposed decisions, and encouraged the authorities to continue implementing their program of adjustment and liberalization, Mr. Fernández Ordóñez said. He shared the authorities' concern about the behavior of investment, which was always the key variable for sustainable growth, and he hoped that the positive signals that had been detected by the staff would be followed by an upsurge in investment. The good results in the first year of implementation of the VAT were also encouraging. Given the great power of such a tax from the point of view of tax collection, he was very optimistic about its contribution to the correction of the fiscal imbalance.

He would appreciate some comments by the staff on foreign direct investment in Tunisia, Mr. Fernández Ordóñez indicated. A number of factors would suggest greater foreign direct capital flows; for example, the law on foreign investment code seemed to be very liberal, and

Tunisia's closeness to the European Communities and its tradition of free, market-oriented policies also ought to encourage investment. He supported the staff's recommendation that trade liberalization be accelerated to permit a better allocation of resources.

It was dangerous to use the bad behavior of industrial countries as an example, Mr. Fernandez Ordóñez commented in, response to Mr. Nimatallah's comparison of Tunisia's inflationary experience with that of certain industrial countries. For example, one would not use the U.S. fiscal policy as an example, nor the Japanese protectionist policy, but rather, the good examples of fiscal policy in the United Kingdom, structural measures in the United States, or the behavior of savings in Japan.

Mr. Kleine said that it was heartening to note that Tunisia continued to be one of the successful performers with a Fund-supported adjustment program. The authorities' cooperation with the Fund and the overall adherence to the adjustment program were paying off. He felt, however, that close attention should be paid to the fiscal position, which remained difficult. When adjusted for grants and exceptional transfers, the deficit for 1989 showed some deterioration. Subsidy payments and wages were the key areas for expenditure-saving measures. In the present circumstances, the authorities would be well advised to heed the staff's recommendation to make only careful use of selective incentives for private investment, because such measures could distort the allocation of resources.

The process of public enterprise reform had gathered some welcome momentum, Mr. Kleine commented. If accompanied by an accelerated import liberalization, that should lead to a further improvement of the new policy environment and to stronger private investment.

The unemployment situation remained a matter for concern, Mr. Kleine noted. While temporary work programs could increase employment somewhat, a more lasting improvement could only be expected if the private sector became a more dynamic source of economic activity.

The authorities should be commended for their preference for maintaining quarterly performance criteria, Mr. Kleine remarked. It would also be welcomed if the authorities would forgo some of the purchases under the extended Fund facility if developments in the external account so permitted. He felt confident that the authorities would make the right decision in that respect at the appropriate time. In conclusion, Tunisia deserved continued Fund support, and he supported the proposed decisions.

Mr. Jones said that the staff report was very encouraging, as it gave a clear indication of the benefits that could accrue from an adjustment program, initially under a stand-by arrangement and subsequently with the appropriate longer-term support under an extended arrangement. The resilience of the Tunisian economy when afflicted by both drought and locusts in 1988 was testimony to the impact of the reforms already undertaken, and to the authorities' commitment to the program.

There had been some minor slippages from the projections for the fiscal deficit and for subsidy reduction, and an increase in the fiscal deficit was projected for 1989, but all the performance criteria, at least until the latest information on net foreign assets, had been met despite the exogenous difficulties, Mr. Jones observed. He would encourage the authorities to ensure no further deterioration on the fiscal side; with private sector investment poised for a rebound, it was important that financing the government deficit should not discourage that. The welcome introduction of a treasury bill tender would help. In that context, he also welcomed the greater flexibility in the financing sector reported by Mr. Ghasimi. Such investment should serve to further export diversification and sustain the current account improvement, given the flexible exchange rate policy, even if the huge benefits of tourism in 1988 proved to have been temporary. Such diversification would become increasingly important as import liberalization proceeded. He noted the staff suggestion that that might be accelerated, but saw no reason to press that too far against the authorities' wishes.

He welcomed the ending of the guarantee system for selected external debt obligations, and looked forward to the end of multiple currency practices, Mr. Jones indicated, although in the clear staff exposition of the program he could find no reference to a timetable for the latter. He supported the authorities in their continuing adjustment program.

Mr. Pétursson made the following statement:

> I would like to join other speakers in commending the authorities on their success and their determination to continue the implementation of the adjustment policies. It is particularly encouraging that basically all performance criteria have been met and that, in some areas, the actual performance has exceeded that envisaged in the program targets. This first program under the revitalized extended Fund facility is certainly encouraging, and we can support the proposed decisions. I would just like to emphasize three economic aspects.
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> First, it is disappointing that revitalization of investment has been much slower than expected. The depreciation of the exchange rate and the tax measures introduced in late 1988 aimed at reducing employment-related costs in industry have not adequately attracted foreign investment and stimulated domestic investment activity. I concur with the staff, nonetheless, that the authorities should be careful in implementing selective incentives which could distort allocation of resources. However, strong efforts in this area by the authorities seem to be warranted in light of the high unemployment rate.
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> Second, the fiscal sector deficit is expected to be about 4 percent in 1989, or slightly lower than in 1988. I concur with the staff that a more rapid adjustment would have been desirable, but agree that it can hardly be expected in 1989. A

reduction of food subsidies is understandably difficult, given that real wages are being restrained for the fifth subsequent year. The authorities should be commended for prudent policies in offsetting part of the overruns by restraining other expenditure categories and particularly for financing a large part of the budget deficit through nonbank domestic savings. In this regard, the introduction of treasury bills is a welcome step toward deepening the monetary market. Careful monitoring of the fiscal sector in the months ahead seems particularly warranted.

Finally, we welcome the steps taken toward the liberalization of trade and exchange payments restrictions. The replacement of the existing guarantees scheme seems appropriate, and I understand from the staff report that the new guarantee arrangement will be self-financing, which is a welcome first step toward abolishing this arrangement altogether. We look forward to following the authorities' progress in this area and their overall efforts to liberalize the external sector.

The staff representative from the African Department noted that several Directors had commented on the desirability of encouraging direct investment and considered it essential that the adjustment program in Tunisia be supported by the same. It was true that the investment code was quite liberal with respect to direct investment, and that the proximity to the European Communities should make Tunisia well poised to take advantage of foreign investment. The staff had been fairly cautious in its projections for the medium-term scenario, and direct investment could well be higher. He did not think that the authorities should take additional measures; the investment code as it stood was adequate. What they should do, and indeed were doing, was to market their economy abroad. For example, in 1988, a very high level delegation had visited the United States to explain the Tunisian market and to encourage direct investment. Similarly, the authorities were organizing various fairs for specific sectors in Tunisia, recently in leather and footwear, and the response of foreign investors seemed encouraging. It was only a matter of time, as the adjustment process took hold and the authorities' commitment to the program became increasingly evident to foreign investors, before the desired response would be seen.

On whether it would be consistent with the tax reform to introduce additional discretionary measures, the staff representative commented that on economic grounds one could probably devise additional measures that could be introduced together with a tax reform without directly contradicting it. However, the authorities felt that public perception would see additional measures as running counter to their intentions. In addition, with a streamlined tax system, the authorities would have a more flexible instrument to use in the future. If needed, they could then

consider raising the VAT rates, and gradually reduce exemptions for those sectors that were performing well. Again, it was a matter of time to permit the authorities to arrive at the appropriate conditions before they acted.

Mr. Ghasimi made the following concluding remarks:

On behalf of my Tunisian authorities, I would like to thank the Executive Board for its continuous support of Tunisia's structural adjustment program and for the pertinent remarks and recommendations which I will personally convey to my authorities. I am confident that they will review carefully Directors' comments and improve, as far as possible, the management of the economy.

My Tunisian authorities would like to point out that while they are encouraged by the gains already achieved since mid-1986, they continue to adhere to a medium-term strategy, which they believe remains the only appropriate way for the economy to embark on a sustainable growth path and to reach a viable external payments position. In this regard, they view the ongoing collaboration with the World Bank and the Fund as an important supportive element to their adjustment program.

Directors may recall that the program envisages a reduction of the fiscal deficit from 5.7 percent of GDP in 1986 to 2.3 percent in 1991; a sizable correction of the current account deficit, programmed to reach 2.2 percent of GDP in 1991 compared with 8 percent in 1986; and a consolidation of external reserves from an equivalent of 1.3 months' worth of imports in 1986 to 3.2 months' worth of imports by the end of 1991.

My authorities are confident that these objectives are attainable, and they will seek to reinforce them as far as possible by building on the favorable outcomes already realized. Their main concerns, shared by many Directors, remain the economy's growth prospects and the critical problem of high unemployment, both of which continue to be adversely affected by exogenous factors, including recurrent droughts. In this respect, they are devoting particular emphasis to the revival of investment in 1989, so as to sustain an appropriate economic growth without undue inflationary pressures.

In any case, they consider further implementation of structural reforms quite important in order to diversify and reorient the economy toward nontraditional exports and to improve external competitiveness. In pursuing these objectives, the authorities are guided by the emphasis being devoted to increased collaboration within the Maghreb.

Finally, I would like to inform Mr. Marcel that my authorities are well aware of the need to restructure the operations of the Subsidy Fund. In this regard, they are carrying a profound review of its operations, and I hope that at the occasion of the next program review I will report to the Board the progress in this area.

The Chairman then made the following summing up:

Executive Directors, expressing agreement with the thrust of the appraisal in the staff report for the 1989 Article IV consultation with Tunisia, welcomed Tunisia's continuing good performance under its adjustment program. The substantial growth of the export and tourism sectors had helped to cushion the economy against the impact of adverse exogenous developments in 1988. The improved external sector position was reflected in a small current account surplus and a significant increase in foreign reserves. Revised projections confirmed that Tunisia should be well placed to maintain a viable balance of payments position in the medium term with continued perseverance in the application of the program.

Directors were concerned about the increase in the overall fiscal deficit in 1988 and urged close monitoring to avoid slippage in that area in 1989. They commended the authorities on the smooth introduction of the value-added tax, without revenue loss. Directors took note of the substantial overrun in price subsidies in 1988, associated with sharply higher international cereal prices and the higher expenditure related to the drought; however, those outlays had been partly offset by the compression of expenditure in other areas.

Directors welcomed the global tax reform under way, which was aimed at streamlining incentives and increasing the flexibility of fiscal policy. They expressed the hope that the unification of direct taxation would also be implemented without a detrimental impact on revenues. The tax reform should be monitored closely and tax administration improved, and the tax revenue/GDP ratio raised. As the tax reforms would not have a positive impact on revenues in the short run, the room for maneuver in fiscal policy would continue to be limited, requiring difficult trade-offs among spending priorities. Directors welcomed the authorities' intention to reassess their subsidy policy so as to target it on the more vulnerable income groups. Directors emphasized that close adherence to the overall fiscal target would be required to support the external adjustment process and to permit a further shift of resources to the private sector, which would contribute to economic diversification and restructuring.

Directors emphasized the role of monetary policy in controlling inflationary pressures and considered the tightening of the monetary objectives for 1989 to be appropriate. They commented that the introduction of treasury bills would enhance the flexibility and effectiveness of monetary control. Several Directors, noting that real interest rates had declined in 1988, welcomed the firming of interest rates in early 1989.

Directors remarked that the authorities' program of cautious macroeconomic policies combined with ambitious structural reform was already beginning to bear fruit, as evidenced by the early signs of stronger and more balanced growth. Given the high level of unemployment in Tunisia, Directors were of the view that structural reforms needed to be pursued decisively. They expressed satisfaction at the progress achieved in drawing up a public enterprise reform program in cooperation with the World Bank. Directors generally stressed the importance of continued price and import liberalization, and some stated that there was scope for accelerating market-opening measures, although there were some who indicated that they agreed with the pace of the liberalization that was under way. Directors also noted with satisfaction the reform of the money market, and encouraged the authorities to move forward in consolidating market-oriented credit and interest rate policies, including the removal of remaining restrictions on interest rates and steps to favor more competition in the banking sector.

Employment creation and a reduction in the high level of unemployment was seen to be a major challenge to the Tunisian authorities. That would require a sustained high level of productive investments, and Directors encouraged the authorities to be active in attracting foreign investment to Tunisia. In that connection, the authorities were encouraged to avoid incentives that could encourage capital-intensive investment.

Directors considered that the authorities' exchange rate policy had contributed importantly to the success of their strategy of export promotion and import liberalization. Directors welcomed the authorities' intention to preserve external competitiveness through the flexible management of the exchange rate. The need to avoid a multiple currency practice was mentioned, and it was noted that the new exchange rate guarantee arrangement would be self-financing.

It is expected that the next Article IV consultation with Tunisia 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 Tunisia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1989 Article XIV consultation with Tunisia, in the light of the 1989 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Tunisia maintains restrictions on the making of payments and transfers for current international transactions as described in EBS/89/58, in accordance with Article XIV, except that the multiple currency practice arising from the operations of the old exchange rate risk guarantee fund established under Law No. 71-59 of December 1971, modified by Law No. 82-91 of December 31, 1982, is subject to approval of the Fund under Article VIII, Sections 2 and 3. The Fund urges the authorities to remove the multiple currency practice and, in the light of the decision of the authorities not to extend any further guarantees under the scheme, grants approval for the practice until April 30, 1990. The Fund is encouraged by the steps already taken to ease restrictions on current transactions and urges an early and vigorous implementation of the intention of further liberalization in this area.

Decision No. 9160-(89/63), adopted
May 24, 1989

Review Under Extended Arrangement

1. Tunisia has consulted with the Fund in accordance with paragraph 4(c) of the extended arrangement for Tunisia (EBS/88/119, Sup. 1, 7/28/88) and paragraph 36 of the memorandum on the economic and financial polices of Tunisia annexed to the letter from the Governor of the Central Bank of Tunisia, the Minister of Planning, and the Minister of Finance, dated June 16, 1988, in order to review progress under the program and to establish performance criteria for 1989.

2. The letter dated March 23, 1989 from the Governor of the Central Bank of Tunisia, the Minister of Planning, and the Minister of Finance shall be attached to the extended arrangement for Tunisia, and the letter of June 16, 1988, together with its annexed memorandum on the economic and financial policies of Tunisia, shall be read as supplemented by the letter of March 23, 1989.

3. Accordingly, the limits referred to in paragraph 4(a)(i) through (iv) of the arrangement shall be as specified in Table 1 of the letter dated March 23, 1989.

Decision No. 9161-(89/63), adopted
May 24, 1989

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/89/62 (5/22/89) and EBM/89/63 (5/24/89).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 88/171 and 88/172 are approved. (EBD/89/150, 5/17/89)

Adopted May 23, 1989

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/132 (5/22/89) is approved.

APPROVED: December 27, 1989

LEO VAN HOUTVEN
Secretary