INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/171

10:00 a.m., November 23, 1988

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| | C. Enoch |
| Dai Q. | |
| | C. S. Warner |
| | A. Rieffel, Temporary |
| | H. S. Binay, Temporary |
| E. T. El Kogali | |
| | M. Hepp, Temporary |
| L. Filardo | M. A. Fernández Ordóñez |
| | A. M. Othman |
| | O. Kabbaj |
| | S. Rouai, Temporary |
| | B. Goos |
| J. E. Ismael | E. Kiriwat |
| | L. E. N. Fernando |
| A. Kafka | |
| | J. Gold, Temporary |
| | K. Yao, Temporary |
| | I. A. Al-Assaf |
| | M. Al-Jasser, Temporary |
| | M. Fogelholm |
| | D. Marcel |
| | G. Serre, Temporary |
| | G. P. J. Hogeweg |
| C. R. Rye | |
| | T. Morita, Temporary |
| | N. Kyriazidis |

L. Van Houtven, Secretary and Counsellor
D. J. de Vos, Assistant

Also Present

G. González, Minister of Planning and Economic Policy, Panama. IBRD: L. E. Derbez, Latin America and the Caribbean Regional Office; D. R. Williamson, Africa Regional Office. African Department: E. A. Calamitsis, Deputy Director; D. J. Donovan, U. R. Gunjal, M. T. Hadjimichael, S. L. Rothman. Exchange and Trade Relations Department: A. Basu, E. Brau, G. R. Kincaid, A. Miyauchi, P. P. Moutot. External Relations Department: A. F. Mohammed, Director; J. Landell-Mills. Fiscal Affairs Department: G. M. Bartoli, B. Nijathaworn. IMF Institute: L. U. Ecevit. Legal Department: J. K. Oh, J. V. Surr. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. Berthet, J. E. Blalock. Western Hemsiphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; M. E. Bonangelino, M. A. Da Costa, J. C. Di Tata, P. C. Leme, L. L. Pérez, S. J. Stephens, E. C. Suss. Special Advisor to the Managing Director: A. K. Sengupta. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, P. E. Archibong, E. Ayales, P. D. Péroz, P. Péterfalvy, M. Pétursson, G. Pineau, S. P. Shrestha, M. A. Tareen, N. Toé, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: F. E. R. Alfiler, S. Appetiti, A. A. Badi, R. Comotto, F. El Fiky, S. Guribye, M. A. Hammoudi, C. L. Haynes, J. Heywood, C. J. Jarvis, J. M. Jones, P. Kapetanović, K.-H. Kleine, K. Kpetigo, T. Morita, J. A. K. Munthali, L. M. Piantini, J.-P. Schoder, Shao Z.

1. PANAMA - 1988 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISIONS ON COMPLAINTS UNDER RULE K-1 AND RULE S-1

The Executive Directors considered the staff report for the 1988 Article IV consultation with Panama (SM/88/226, 10/19/88; and Cor. 1, 11/2/88), together with a staff paper on the further review of decisions on complaints under Rules K-1 and S-1 relating to Panama's overdue financial obligations to the Fund (EBS/88/236, 11/18/88). They also had before them a background paper on recent economic developments in Panama (SM/88/244, 11/4/88).

Mr. Gustavo González, Minister of Planning and Economic Policy of Panama was also present.

Mr. González made the following statement:

My Panamanian authorities have no disagreements with the staff's description or analysis of the very difficult economic situation faced by Panama.

Panama pursued a highly successful growth-oriented adjustment program to end-1986, with the support of two successive stand-by arrangements. This program, as Directors will recall, relied on demand-management policies and measures to enhance the productivity of the economy. Public sector expenditures were reduced by no less than 8.3 percent of GDP. Public sector revenues were strengthened; the domestic sales price of petroleum products was raised; trade reform was implemented through the substitution of quotas by ad valorem tariffs, together with the elimination of price controls on affected items; and tariffs on manufactured and agricultural imports were reduced. As a result, the public sector deficit was reduced from 10.8 percent of GDP in 1982 to 0.4 percent of GDP in 1986. The average annual inflation rate during this period was only 1.2 percent--a reflection of prudent wage and price policies--producing a depreciation of the currency in real effective terms. Thus, the current account of the balance of payments shifted from a deficit of 9.5 percent of GDP in 1982 to a surplus of 2.0 percent of GDP in 1986. Debt service in relation to exports of goods and nonfactor services declined by 9 percentage points, to 28 percent. Economic growth during the second half of the period averaged 3.7 percent.

My authorities sought a new arrangement from the Fund in 1987. However, a deterioration in the political situation prevented the authorities from concluding both negotiations with commercial banks and the necessary policy understandings with the Fund. In spite of these circumstances, the authorities continued to implement prudent demand-management policies to consolidate the achievements of the previous years. As fiscal

policy is the main instrument of financial management in Panama, this prudence was reflected in the deficit of the public sector being kept below 1 percent of GDP. The surplus in the current account of the balance of payments, in relation to GDP, remained at almost the same level realized in 1986. The rate of growth was 2.8 percent, and, while lower than that achieved in 1986, it remained positive in per capita terms.

The external payments restrictions imposed by the U.S. Government in early 1988 and the sharp reduction of financing from foreign creditors since 1987 caused a sharp decline in gross domestic investment, to 2 percent of GDP in 1987, compared with 17.4 percent of GDP in 1986. Output is projected to plunge by almost 20 percent in 1988 and nominal GDP by essentially the same percentage.

Owing to the openness of the economy, the external payments restrictions imposed on Panama impinged directly on the financial sector and forced my authorities to close the banking system for nine weeks to avoid its collapse, as total liabilities to the private sector declined by 17 percent during the first five months of this year. Because the U.S. dollar is legal tender in Panama, the payments mechanism was seriously disrupted. My authorities adopted rigorous measures to contain the financial crisis by restraining domestic demand. Since May some of the financial restrictions imposed by the authorities have been lifted progressively, permitting the use of bank deposits for payments to the public and private sectors. The current account of the balance of payments is projected to yield a surplus equivalent to 7.6 percent of GDP, but merchandise imports will decline to their lowest level during this decade.

The fall in economic activity and the prohibition by the U.S. Government of payments by U.S. companies for local taxes and the cost of some public services have created an unprecedented lack of liquidity for the Government. The current revenues of the Central Government are forecast to decline in 1988 by 45 percent in relation to 1987. This difficult situation has forced the authorities to cut back current expenditures, to the point at which, essentially, only wages and pensions are being paid. The dismissal of employees has been avoided, in view of the rising rate of unemployment in the economy; but civil servants have been encouraged to take early retirement and those receiving pensions have been required to resign from current jobs. Noninterest, nonsalary, and nonpension expenditures are expected to fall drastically. Capital expenditures are projected to decline to 0.5 percent of GDP. The careful handling of public finances will prevent any major increase in the deficit of the public sector on a cash basis; the fiscal deficit will rise to only 1.3 percent of GDP,

compared with 0.7 percent in 1987--a percentage increase partly owing to the fall in GDP. The deficit will be financed through domestic sources.

My authorities express their commitment to keeping on track the adjustment process begun in 1983 and to avoiding any measures that will ease the strict fiscal program and continue trade liberalization, in spite of the effects of the external measures currently being endured. They are aware that the financial crisis has exacerbated the debt problem, particularly in the current year when the highest amortization payments are due. Two indicators can highlight the acuteness of the debt burden in 1988: debt service in relation to public sector revenues will jump by 150 percent to a level of 85 percent, and debt service in relation to exports of goods and nonfactor services will nearly double to a level of 59 percent in 1988. My authorities reiterate their full commitment to resuming payment of external and internal obligations as soon as the financial crisis is resolved.

With respect to the medium-term outlook, assuming that foreign sanctions will be lifted, the staff projects a strong increase in output and a strong recovery in investment expenditure. The current account of the balance of payments would be in surplus during the period, boosted by a rapid increase in exports of goods and services. The closing of the capital account gap will require the rescheduling of debt and the re-establishment of foreign financial flows to the 1983-86 level. To this end, the authorities consider that the rescheduling of the debt must be concerted at reasonable levels that guarantee a positive flow of resources to support an investment program that will allow a quick recovery of the economy.

My authorities would like to emphasize to the Board that Panama is clearly one of the countries that, despite its willingness to pay, is impeded from clearing external payments obligations by circumstances entirely beyond its control. Since the imposition of the external measures that the nation is suffering, Panama has not been able to make any payments to external creditors, as the assets of the Government's official depository were sequestered in the United States, causing the closing of Panamanian banks. Despite its severe liquidity constraint, Panama made modest payments to the Fund recently, in recognition of the Fund's preferred creditor status.

Extending his remarks, Mr. González said that Panama assigned maximum priority to meeting its obligations to the international financial community and particularly to the Fund, which it recognized as having preferred creditor status. For Panama to be able to re-establish normal relations with the international financial community, it would be

necessary to recover the sequestered funds and assets that had previously been available to the authorities. When access to the latter had been restored, Panama would be able to return to its past compliance in meeting its financial obligations and to resume growth, as was the case until midway through the previous year.

Mrs. Filardo made the following statement:

The staff papers provide a well-balanced view of the current sociopolitical and economic situation in Panama. From the staff's analysis, it is very clear that prior to the political developments that unfolded into the current situation, Panama's economic performance was highly satisfactory. The Fund- and Bank-supported adjustment programs implemented in 1983-84 and 1985-86 had yielded very positive results. A well-balanced combination of macroeconomic policies and structural changes in the economy had produced several years of solid growth and domestic stabilization that were characterized by extremely low rates of inflation. The sharp reduction in the domestic and external imbalances, such as the reduction in the fiscal deficit from almost 11 percent of GDP in 1982 to less than half a percentage point of GDP in 1986, as well as the shift of the external current account deficit into surplus during the same period, are clear evidence of the soundness of the policies being implemented, and of the authorities' commitment to achieving their economic objectives.

The political situation prevailing since the second half of 1987 has, nevertheless, caused serious economic damage and financial disruptions. The escalating political unrest, compounded by the sanctions imposed by the U.S. Government, has had severe consequences in many areas. Despite the authorities' efforts to scale down public expenditures, the sharp reduction in nonfinancial public sector revenues has resulted in an abrupt deterioration of the public sector finances. Furthermore, important shortfalls in disbursements of multilateral credits were accompanied by net loan repayments to other creditors. The resulting large increase in the public sector's domestic borrowing requirement was, in turn, compounded by a severe crisis of confidence in the private sector, all of which explain the drastic contraction in economic activity during the past year and a half.

It is evident that the authorities have tried to respond to the very difficult circumstances facing the country by adapting their economic policies within the limitations imposed by the political situation. For example, it is encouraging that while they are making efforts to strengthen fiscal revenue collections, they are also trying to adjust expenditures to the reduced level of such revenues. However, very little room for maneuver is left in this area; and, unless the political

situation is resolved properly and the external sanctions lifted, the economic disruptions can only be aggravated. For example, the 80 percent reduction in central government capital expenditure in 1987 alone is extremely worrisome, and is a clear example of an adjustment that could have lasting damaging consequences on the country's growth prospects.

Panama's difficulties in fully servicing its external financial obligations have to be viewed in the former context. The sharp reduction in government revenues, the shortfall in official disbursements and, in general, the crisis of confidence in the financial sector have exacerbated the country's external debt problems. The solution to the current political situation and the concomitant restoration of traditional sources of external financing is a necessary, although not sufficient, condition for setting the Panamanian economy back on track. While the situation is being resolved, and while I am fully aware of the enormous limitations that the authorities face, there is no other alternative for the authorities but to assume significant adjustment measures that will affect the future of the country.

My authorities have serious reservations about endorsing the proposed decision. It would be recalled that when the Board discussed the report on overdue financial obligations that was to be submitted to the Interim Committee, Mr. Cassell requested the staff to assess the difference between willingness and ability to pay. In my authorities' view, the current case is a very special one in which the authorities are willing to pay but are unable to do so, as Minister González has rightly stressed. Thus, the Board should not treat Panama as a standard case by applying the same procedures that it uses in other cases. There should be means of differentiating between such cases, especially in view of the effort made by the authorities to clear their arrears to the Fund--as the recent goodwill payment demonstrates. I oppose the proposed decision.

Mrs. Hepp made the following statement:

The recent regrettable economic developments in Panama have been related closely to the political difficulties and uncertainties that have emerged since the second half of 1987. As Minister González indicated, these developments show a clear turn from the economic situation prevailing in 1985-86, when the implementation of sound economic measures was showing positive results in terms of growth and stable domestic and external conditions. The financial difficulties that began in 1987 were exacerbated by political factors, resulting in substantial costs to the country. In fact, real GDP is expected to decline by as much as 20 percent in 1988, and the unemployment rate--which was

in the range of 10-12 percent during the period 1983-87--is expected to rise to about 20 percent. In the meantime, helped by the introduction of price controls, inflation has remained practically nonexistent; and the external current account surplus is projected to increase significantly, owing mainly to the lack of financing and the decline in economic activity. With this situation in mind, I cannot but agree with the thrust of the staff appraisal.

There is no doubt that the main economic difficulties of Panama are reflected clearly in the deficit of the nonfinancial public sector. Initially, the deficit was financed by the National Bank; but, at the end of 1987, the public sector resorted to accumulating arrears. I note the sharp fall in fiscal revenues that is associated partly with the restrictions imposed by the United States early this year. The authorities have reacted correctly under the existing circumstances by restricting fiscal expenditure; particularly noteworthy is the estimated cut in investment expenditure by 65 percent in 1988. With respect to current expenditures, I note the freeze on the Government's wage bill, as well as the authorities' intention of reducing public employment by promoting early retirement. In this connection, the shift of the Social Security Agency to a significant deficit position is a cause for concern. Even if part of the latter deficit results from the decline in tax collections associated with the increase in unemployment, I note that it is also the result of the increase in pension payments. This situation, as well as the expectation of widening social security deficits in the future years, calls for prompt action. As the staff indicates, the first steps should focus on better management of the Social Security Agency; but, in addition, the reform of the pension system seems to be called for. Furthermore, the surplus position of public enterprises and decentralized agencies could be increased further by strict control of wages, thereby generating the needed counterpart funds for investment projects. This should be an area where further efforts could be made if the situation does not improve in the short term.

I note the disruption in the payments system that occurred early this year, as well as the significant deposit withdrawals and the weak liquidity position of the banking system. In this respect, the measures implemented were the appropriate ones under current circumstances, and are clearly justified to avoid further capital flight. I agree with the authorities' views on the disadvantages of introducing a Panamanian paper currency, which would not necessarily facilitate the payments mechanisms in the country.

The accumulation of arrears is undoubtedly the cause of most concern. The lack of liquidity is not only restraining the

import capacity of the country, but is also encouraging capital outflows, making it impossible for Panama to settle its external obligations. It appears that Panama has made no payments to the Fund or to any other creditor since the U.S. sanctions were imposed in early 1988, followed by the closing of banks.

Given Panama's particular circumstances, its authorities have implemented the appropriate emergency measures required by the difficult situation. These measures are clearly of a temporary nature. I hope that Panama's main problems can be resolved soon, and that the authorities can adopt an economic program that would allow them to restore both domestic and external balance and to normalize their relations with the international financial community. This is stated clearly in the proposed decision, which I fully support.

Mr. Rye made the following statement:

The Minister's presence at the Board serves as an earnest of Panama's strong desire to maintain good relations with the Fund. Implementation of the Fund's collaborative approach to resolving the arrears problem will be particularly difficult in Panama's case, given the political problems and external restrictions confronting the authorities. The staff papers for the Article IV consultations document the severe impact of these developments on the Panamanian economy. The most dramatic illustration of the change in circumstances is the fall in real GDP of 19.2 percent in 1988, after a period of relatively consistent growth of about 3-4 percent during the previous few years.

The authorities have correctly focused their efforts on seeking to constrain public sector spending. The wage bill has been frozen, and some cutting of staff levels is taking place. The scope for further cuts in current expenditure is limited, however, by the predominance of wages and salaries. The result is that public investment has been reduced substantially to about 20 percent of the levels reached in 1986-87.

The economy-wide supply disruptions associated with Panama's political and social turmoil have also necessitated a move back toward reliance on price controls for basic and other consumer goods, together with a hiatus in the process of trade liberalization. Earlier gains made in liberalizing trade and prices have therefore been seriously eroded.

All this is especially frustrating given the authorities' success under consecutive stand-by arrangements in 1983-84

and 1985-86 in strengthening the Government's revenue base, generally restructuring the fiscal accounts, and pursuing more efficient resource allocation.

Long-term economic policy in Panama is in a state of siege, and it is difficult to look realistically beyond the short-term demands of "crisis management." In the circumstances, the relevance of the staff's medium-term balance of payments projection, based on the "normalization" scenario, is especially questionable. Significant damage could already have been done as a result of the curtailment of investment and the erosion of private confidence; and were the current restrictions to be sustained for any length of time, the damage--both economic and social--could take many years to reverse.

The solution to many of Panama's current problems is obviously not directly under the authorities' control, and it would be unwarranted to be especially critical of the policies adopted by them. The danger is that "emergency" measures will become entrenched, with potentially long-term damage to the economy. Perhaps the best advice the Board could proffer at this juncture would be to urge the authorities to make special efforts to take advantage of the impetus provided in Berlin to the collaborative approach for clearing arrears and for re-establishing normal relations with the Fund. That at least would help to reopen the door to the external support necessary for the momentum of earlier adjustment efforts to be regained.

In that respect, I very much welcome the statement by the Minister of his Government's full recognition of the Fund's preferred creditor status, and his revelation that Panama recently made a modest payment to the Fund. I assume that the payment postdates the issue of EBS/88/236 (11/18/88), which states that Panama has made no payments to the Fund since the Board's previous consideration of the country's arrears on August 24 (EBM/88/126). It is surprising that the staff did not take the opportunity at the beginning of the meeting to make reference to these payments, and I would welcome its comment.

The decision is obviously a difficult one, but perhaps I can support the proposed draft.

The staff representative from the Treasurer's Department observed that the Fund had received a payment of SDR 100,000 from Panama on November 22. With that payment, and the additional obligations that had fallen due, Panama's arrears were currently SDR 86.6 million.

Mr. Goos said that the Minister's remarks were most encouraging, as they demonstrated clearly that the Government was aware of the potentially serious repercussions for the economic prospects of Panama if current

developments were allowed to go unchecked. He was especially encouraged by the indications given of the Government's willingness to restore normal relations with the Fund, which the partial payment demonstrated. Nonetheless, the Minister would appreciate that for policy reasons clearly in the interest of the Fund membership at large, the Board would have to insist on prompt settlement of the arrears. The authorities should adhere to the staff's recommendations and pursue the clearance of their overdue financial obligations to the Fund as a matter of utmost priority. He supported the proposed decision.

The Chairman said that some amendments to the decision would be necessary to take into account the payment made by Panama and its recognition of the Fund's preferred creditor status.

Mr. Al-Assaf observed that Panama's circumstances were different from those of other countries in arrears to the Fund. Panama was temporarily unable to pay for reasons that he hoped the two countries directly involved would soon be able to resolve. As paragraph 3 of the proposed decision had little relevance to the situation, he suggested that it be deleted.

Mr. Warner observed that many of the preceding statements had been constructive. Even so, the staff report might have been strengthened if more emphasis had been placed on the deterioration in the financial situation during 1987. It was unreasonable to focus solely on the events since early 1988, to the detriment of a relevant historical record going back to at least 1983. He therefore differed with the remarks made in Mr. Kafka's opening statement that the current circumstances were entirely beyond the authorities' control. The U.S. authorities appreciated the token payment made by Panama, but were concerned about the situation in the country and particularly with the general welfare of the Panamanian people.

The Board should support the proposed decision from a sense of responsibility toward the Fund's policy on arrears, Mr. Warner considered. The issue was not one of standardized versus nonstandardized treatment of countries in arrears to the Fund, and it would be a mistake to make such a distinction. The case was a difficult one, but the decision would offer an important 90 days for the Fund to re-examine the situation in Panama. Support for the current decision would not in any way deter Directors from making a more careful and thoughtful examination of conditions in Panama, before considering taking further action. Board decisions with respect to Panama would become more realistic with the passage of time. In any event, the presence of Mr. González was a clear affirmation of the Government's interest in pursuing adjustment and addressing immediately its arrears to the Fund and to other creditors; perhaps it was also an initial step toward normalizing relations with the Fund.

Mr. Rye said that he disagreed with Mr. Al-Assaf's suggestion that paragraph 3 be deleted, as the paragraph was relevant. The first sentence of paragraph 2 was in greater need of change and should be redrafted in

words to the effect that: "the Fund welcomes the recognition by Panama of the Fund's preferred creditor status and the token payment made by Panama. It notes, however, the financial burden placed on other members by the continuation of substantial arrears. The balance of paragraph 2 and the rest of the draft decision could remain.

The Chairman noted that the last sentence of paragraph 2--"the Fund again urges Panama to give the highest priority to the full and prompt settlement of the overdue financial obligations to the Fund"--could no longer be used, because Mr. González had just said with great clarity that Panama fully intended to give such priority to Fund arrears.

Mr. Al-Assaf said that he had recommended deleting paragraph 3 in recognition of the political nature of Panama's economic problems, which the adoption of a financial program could not solve.

Mr. Kyriazidis said that his thinking was in line with that of Mrs. Filardo and Mr. Al-Assaf. Although he recognized the validity of the remarks made by Mr. Goos, the draft decision did not reflect the situation in Panama. Wording similar to that in paragraph 3 had been used on a number of other occasions, but like Mr. Al-Assaf, he found it entirely unrealistic; Directors could not recommend that the authorities adopt and implement a financial program to normalize relations with the Fund under the current political conditions. As a matter of principle, the Fund could not intervene in political matters, but neither could it go beyond a certain point and ignore political reality totally. Thus, he recommended that paragraph 3 be eliminated or radically redrafted to reflect better the situation by, for instance, including a sentence inviting not only the Panamanian Government, but all other member governments to cooperate in providing a solution, including a priori action if necessary.

Mr. Rye said that he wanted to point out to Mr. Al-Assaf and Mr. Kyriazidis that paragraph 3 contained the only statement of the Fund's readiness to cooperate with Panama and that it would be regrettable if that thought was lost. Perhaps the objections that had been raised could be overcome if a compromise wording for the first sentence of paragraph 3 was adopted, to the effect that "the Fund calls on the authorities to adopt a financial program appropriate to Panama's present circumstances...."

Mr. Kyriazidis noted that paragraph 3 needed a more extensive redrafting than Mr. Rye had recommended.

The Chairman said that the Minister's remarks had demonstrated the authorities' recognition that adjustment would still be necessary even if the sanctions were lifted. It would therefore not be unrealistic to express the Fund's willingness to support an adjustment program by the authorities.

Mr. Kyriazidis agreed, but noted that normalization of relations between the countries concerned was an essential condition for the progress to be made toward adopting an adjustment program.

Mr. Al-Assaf said that instead of calling on the authorities to adopt an adjustment program, the Fund should recognize the latter's intention of doing so.

Mr. Fogelholm said that he supported Mr. Rye's proposed changes to paragraph 2. Like Mr. Al-Assaf and Mr. Kyriazidis, he did not think that the first sentence in paragraph 3 recommending that the authorities adopt an adjustment program was realistic. It could be stated instead that the authorities were trying to adjust to the new situation, or that, "the Fund calls on the authorities to consider policies aimed at restoring....and that the Fund stands ready to cooperate with Panama in this endeavor."

Mr. Goos noted the concerns expressed by previous speakers, particularly with respect to the political constraints facing Panama. He also drew attention to the Chairman's comment that the authorities would have to adopt an adjustment program regardless of political developments. In that connection, if the Board began to take political circumstances into account when making decisions, he feared that considerable difficulties would be encountered, with detriment to the Fund's intention of being treated as a preferred creditor. He was therefore most reluctant to see the proposed decision changed. As was made clear by the staff paper, and as the Minister seemed to recognize, Panama needed to address substantial economic problems despite the political situation. Thus, why not retain the reference in the draft decision to the need for the authorities to adopt an adjustment program which did not imply that imbalances had to be resolved overnight.

The Chairman remarked that Mr. Goos's point was a fair one, but he pointed out that the Interim Committee had placed a great deal of emphasis on the distinction between willingness and ability to pay when endorsing the collaborative strategy for dealing with arrears at the most recent Annual Meetings. Some members of the Committee had been forceful in drawing that distinction. Moreover, during the current discussion, the Minister had been particularly explicit in noting the authorities' intention to assign "maximum priority" to discharging their financial obligations to the Fund and of giving special recognition to the Fund's preferred creditor status. The Minister had used strong words indeed, ones that the Board wanted to hear but that were not heard frequently. It would be fair and desirable, in his view, to include a reference to the authorities' attitude in the decision and to the need for adjustment beyond what was called for by the authorities' very special circumstances.

Mr. Kyriazidis commented that the Fund should indeed make decisions that could not be attacked as being unfair or as resulting from a deliberate oversight of realities. There were dangers in not speaking very concretely on political constraints, particularly in the current case of a member country having its assets impounded by a judicial decision in

another country, and especially with the latter's currency being legal tender in Panama. The U.S. authorities had put orders into effect preventing U.S. companies from paying taxes in Panama. It was therefore not a vague situation that could get the Fund into difficulties with its policy on arrears. He could support the decision if reasonably clear mention was made of the need to settle the special dispute between the two countries involved so that the Panamanian authorities could proceed with an adjustment program.

Mr. Ismael stated that the Fund always prided itself on its case-by-case approach, of which Panama was a special example. That status should be reflected in the draft decision, whether by amending paragraph 2 or paragraph 3. He basically supported Mr. Fogelholm's suggestion.

Mr. Fogelholm noted that his chair would always place great emphasis on the equal treatment of member countries. He remarked with respect to the comments of Mr. Goos that paragraph 4, the operative part of the decision, placed Panama on an equal footing with other member countries. Changes to paragraph 3 would rightly address a situation that was not solely economic in nature.

Mr. Goos said that although he recognized the existing political constraints, how would Directors differentiate between the current situation and a political stalemate in a parliament that prevented a government from taking necessary action to make repurchases? How could the current case be distinguished from that of a country in civil war? Assuming that authorities in general were not deliberately interrupting their payments to the Fund, Directors could refer to special political constraints in all countries in arrears to the Fund. He therefore warned against Directors differentiating excessively with respect to political circumstances, while pointing out that all countries in arrears to the Fund, regardless of their particular circumstance, needed to adopt adjustment measures.

Mrs. Filardo noted that there was a significant difference between Panama stopping its payments to the Fund and a country doing so because it had decided that its debt service payments should not exceed a specified percentage of its exports. Moreover, given that the staff was in the process of preparing a paper for the Interim Committee on the modalities of approaching different overdues cases, how, in the meantime, was it possible for the Fund in any realistic sense to help the authorities design an adjustment program?

Mr. Warner said that the reference to the need for adjustment in paragraph 3--particularly the wording that "the Fund stands ready to cooperate with Panama in the formulation of such a program"--did not imply that the staff would design an irrational adjustment program unsuited to the circumstance of Panama. The recommended program would become tailored to the special conditions in Panama by virtue of the staff's work and therefore would, in effect, reflect the case-by-case application of Fund policy. There was a risk that Directors could begin to customize decisions to the extent that none would be the same, a point of his that

remained valid irrespective of the parallel need to avoid complete standardization. In other words, the case-by-case approach might lead to a situation in which there was no clear understanding of where to draw the line between standard and nonstandard treatment of countries and of how to interpret cases when they were in fact so demarcated.

The Chairman agreed that the wording of the last sentence in paragraph 3 was appropriate, and that it did not imply that the Fund supported adjustment programs in the abstract, but ones that dealt with the realities of an economy. In view of the comments of the Minister, it was appropriate to change the wording of the draft decision. The Minister had made important remarks indicating that the authorities were ready to normalize relations with the Fund and that they recognized the Fund's preferred creditor status, to which the Board attached the greatest importance. Those points should be reflected in the decision.

The staff representative from the Western Hemisphere Department said that given the circumstances in Panama, the authorities obviously needed to formulate financial policies in the best manner possible, especially to arrest the deterioration in the public finances. It was highly unlikely that one could envisage a full-fledged adjustment program supported by external creditors, with arrears cleared, and accompanied by an adequate level of investment. In view of the fiscal revenue prospects that the authorities were facing, one could only envisage them continuing to maintain a cautious expenditure policy. The medium-term scenario in the staff report assumed that the political situation would change substantially in 1989 and that the authorities would be implementing an adjustment program requiring the full support of external creditors. It was true that the situation that the authorities were facing was very different from that in the projection.

Mr. González observed that the discussion had been constructive and that many Directors had noted the extremely delicate circumstances of Panama. He especially thanked Mrs. Filardo for her comments.

The Chairman made the following summing up:

> Directors were in broad agreement with the appraisal contained in the staff report for the 1988 Article IV consultation.
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> They noted that following the successful adjustment programs implemented during the period 1983-86, which helped to restore the basis for economic growth and strengthened the balance of payments, the Panamanian authorities had continued to maintain a restrained fiscal policy stance in 1987 and 1988. However, the Directors expressed grave concern about the economic and political difficulties that had emerged in 1988, with some indicating the difficulties were, inter alia, a consequence of external payments restrictions. Those difficulties had contributed to a weakening of government revenues, a

disruption in the payments system, an erosion of private sector confidence, a contraction in economic activity equivalent to some 19 percent of GDP, and a halting of the progress in the internal and external liberalization of the economy.

Directors observed that the projected widening of the overall public sector deficit to 9 percent of GDP in 1988 was the result of a sharp fall in revenue following the imposition of sanctions against the country. They noted the sharp cutbacks in expenditures, and observed that it might not be feasible to adjust expenditures fully to the steep decline in revenue in the short run. They urged the authorities to take all steps necessary to limit the decline in revenue and to implement administrative procedures to ensure a prompt resumption of revenue collection once foreign sanctions were lifted. In line with the authorities' view, Directors felt that because of the sharp reduction in public investment, and given the low level of discretionary spending, efforts to reduce expenditures would need to include adjustments in the wage bill. Directors encouraged the authorities to reconsider the implementation of the pension reforms that was postponed in 1987.

With regard to the external position, Directors observed that, owing to a sharp decline in merchandise imports, the current account would show a surplus equivalent to some 7.5 percent of GDP. Nevertheless, Directors noted the weakened liquidity position of the domestic banking system due to the freezing of the National Bank's assets in the United States and the subsequent large deposit withdrawals. They were encouraged by the easing of the restrictions on deposit withdrawals and urged the authorities to eliminate the restrictions fully as soon as conditions allowed so as to permit the re-emergence of a well-functioning payments system.

Directors welcomed the payment made this week by Panama to the Fund. They were of the view that, notwithstanding the difficult fiscal and liquidity situation, the authorities should give the highest priority to Panama meeting its financial obligations to the Fund. They warmly welcomed the assurances to that effect given by the Governor of the Fund for Panama, and the indication that Panama recognized the Fund's preferred creditor status. They urged Panama to take full advantage of the new collaborative approach, endorsed by the Governors at the Berlin meetings, to restore as soon as possible normal relations with the Fund, once the external payments restrictions were removed.

It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

The Chairman asked the Secretary to offer appropriate modifications to the draft decision.

The Secretary said that the Board, with respect to paragraph 2, seemed to want to capture three points in the first few sentences: that Panama recognized the Fund's preferred creditor status; that Panama was committed to giving the highest priority to the settlement of its overdue financial obligations to the Fund; and that Panama had recently made a payment to the Fund. Based in part on Mr. Rye's suggestion and using most of the first and last sentences of the existing paragraph, the text could read: "the Fund welcomes the recognition by Panama of the Fund's preferred creditor status and Panama's commitment to give the highest priority to the full and prompt settlement of the overdue financial obligations to the Fund." The Fund also welcomes the payment received from Panama. Nevertheless, the Fund regrets the continuing nonobservance by Panama of its financial obligations to the Fund in the General Department and with respect to special drawing rights and notes the financial burden placed upon other members by the continuation of these arrears."

Mr. Kafka suggested that the statement that "the Fund welcomes the payment made by Panama" should be the first sentence of the paragraph.

The Secretary said that a more tentative approach was required in redrafting paragraph 3, to reflect the belief of some Directors that the current language adequately encapsulated the thought that any proposed adjustment program would take into account the individual circumstances of Panama, while paying due regard to the view expressed by some other Directors that the Fund should more properly welcome the authorities' commitment to adopting such an adjustment program. The latter point would follow from the opening statement made by the Minister. Paragraph 3 could begin with the words "the Fund welcomes the determination of the authorities to adopt a financial program," and then continue as worded originally.

The Chairman asked the Minister for his views of the proposed changes to paragraph 3.

Mr. González welcomed the recognition of the Panamanian authorities' inability to adopt a concrete adjustment program--particularly in view of the very uncertain financing situation--and also the reference to the Fund's willingness to cooperate with Panama. Of course, the authorities' view remained that the economic difficulties were a consequence of the political situation. He could therefore accept wording along the lines suggested by Mr. Fogelholm.

The Secretary then suggested that the first sentence of paragraph 3 be amended to read, "the Fund welcomes the determination of the Panamanian authorities to pursue the adjustment process begun several years ago and urges the authorities to adopt policies aimed at restoring...."

Mr. Kafka recommended deleting the reference to urging the authorities to adopt adjustment policies, as the Minister had indicated that they were already committed to such action. The wording might read, "The Fund welcomes the determination of the Panamanian authorities to pursue the adjustment process and to adopt a set of policies aimed at restoring...."

The Chairman added that the word "program" in the last sentence of paragraph 3 should then be changed to "policies" to be somewhat less specific and to take into account the special nature of the case.

Mr. Warner suggested that the word "commitment" replace the word "determination."

The Chairman remarked that the word "commitment" had in fact been used by the Minister in his statement.

Mrs. Filardo remarked that she wanted her opposition to the decision, even as amended, to be registered.

The Executive Board then took the following decision:

1. The Fund has reviewed further Decision No. 8899-(88/91), adopted June 8, 1988, and Decision No. 8900-(88/91) S, adopted June 8, 1988, in light of the facts described in EBS/88/236 (11/18/88) pertaining to Panama's overdue financial obligations to the Fund.

2. The Fund welcomes the payment made by Panama. The Fund also welcomes the recognition by Panama of the Fund's preferred creditor status and Panama's commitment to give the highest priority to the full and prompt settlement of the overdue financial obligations to the Fund. Nevertheless, the Fund regrets Panama's continuing nonobservance of its financial obligations to the Fund in the General Department and with respect to special drawing rights and notes the financial burden placed upon other members by the continuation of these arrears.

3. The Fund welcomes the commitment of the authorities to pursue the adjustment process begun several years ago and to adopt policies aimed at restoring external and internal balance and normalizing Panama's relations with the international financial community. The Fund stands ready to cooperate with Panama in the formulation of such policies.

4. The Fund shall review further Decision No. 8899-(88/91) and Decision No. 8900-(88/91) S within a period of three months from the date of this decision, if any financial obligations of Panama are overdue at the time. Unless by the time of that review Panama is current in its financial obligations to the Fund in the General Department, the Fund will consider the appropriateness of further steps, including the

possibility of declaring Panama ineligible to use the general resources of the Fund pursuant to Article XXVI, Section 2(a). Furthermore, unless by the time of that review Panama is current in its financial obligations with respect to special drawing rights, the Fund will consider the appropriateness of further steps, including the possibility of suspending Panama's right to use SDRs it acquires after that date, pursuant to Article XXIII, Section 2(b), other than for settlement of financial obligations to the Fund.

Decision No. 9025-(88/171) G/S, adopted
November 23, 1988

2. REPORT BY STAFF - SOVIET VISIT

The Chairman asked the Director of the External Relations Department to give a brief report on a recent informal visit by Soviet officials to the Fund.

The Director of the External Relations Department said that a Soviet delegation, consisting of senior officials of the State Bank of the Union of Soviet Socialist Republics, the Ministry of Finance, and the Ministry of Foreign Affairs had paid an informal visit to the Fund from November 1 through November 3, following a visit of similar duration to the World Bank. The visit to the Fund was coordinated by the External Relations Department. In addition to himself, the delegation had met with senior officials and staff in the European Department and in all of the functional departments of the Fund.

The Soviet officials had indicated that the objectives of their visit were threefold: to learn about the activities and policies of the Fund at first hand; to obtain a clear view of the obligations and responsibilities of membership; and to explore the possibilities of establishing informal contacts between Soviet officials, scholars, and Fund staff, the Director continued. During the meetings, the staff gave answers on a factual basis to the Soviet officials' questions with respect to the organizational structure and decision-making processes of the Fund; the Fund's financial structure and operations; the Fund's research program, particularly its work on the international monetary system, including the SDR; the world economic outlook exercise; fiscal matters in Fund-supported adjustment programs; technical assistance provided by the Fund; and relations with member countries, particularly the consultation and surveillance procedures.

The staff was able to provide the Soviet officials with information on the responsibilities and obligations of membership on the basis of published material only, the Director noted. In answer to specific questions, it explained the general requirements for calculating a member's quota, including the payment of the quota and the remuneration

paid on the reserve position, as well as the legal implications of membership, particularly the obligations under Article IV, and Articles VIII and XIV concerning exchange restrictions and the provision of information to the Fund.

The Soviet team had broached the possibility of having Fund staff attend appropriate conferences organized by Soviet officials, and the possibility of Soviet scholars and officials attending similar conferences organized by the Fund, the Director pointed out. They had also brought up the possibility of seconding Soviet scholars to the Fund for specified periods. The Soviet officials favored the continued exchange of published information. The staff agreed to consider the suggestions from the Soviet side.

The Chairman noted that, owing to the Soviet Union's importance, he had felt that it was necessary to inform the Board fully of the discussions with the U.S.S.R. officials.

Mr. Warner inquired when the Fund would respond to the Soviet officials' questions, particularly with respect to the proposed reciprocal visits of the staff and Soviet scholars.

The Chairman responded that the Fund would consider the suggestions, but had not given a timetable for replying.

The Director of the External Relations Department confirmed that the staff had given no date for replying to the Soviet officials' suggestions, although the latter had referred to inviting staff to a conference in Moscow in May.

The Chairman added that the consideration would be given on a case-by-case basis.

The Deputy Managing Director assumed the chair.

## 3. THE GAMBIA - 1988 ARTICLE IV CONSULTATION, AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1988 Article IV consultation with The Gambia and The Gambia's request for an enhanced structural adjustment arrangement (EBS/88/214, 10/20/88), together with a policy framework paper (EBD/88/289, 10/19/88). They also had before them a background paper on recent economic developments in The Gambia (SM/88/245, 11/7/88).

The Acting Chairman made the following statement on behalf of the Managing Director:

> There follows for the information of Executive Directors the text of a memorandum that I have received from the President

of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their November 15, 1988 discussion in Committee of the Whole of a paper entitled "The Gambia: Policy Framework Paper, 1988/89-1990/91."

1. The Executive Directors, meeting as a Committee of the Whole, reviewed the third-year policy framework paper, 1988/89-1990/91. The Executive Directors commended the Government of The Gambia for its sustained commitment to implementing its Economic Recovery Program (ERP). While the Gambian economy remains fragile and heavily dependent on external assistance, they noted that favorable economic and financial performance to date has enabled The Gambia to meet and in some cases exceed the original objectives of the ERP. In this respect, The Gambia provides a striking example of the benefits of a flexible exchange rate policy in combination with disciplined financial and monetary management. The Executive Directors expressed strong support for the objectives and economic strategy outlined in the policy framework paper.

2. The Executive Directors' concerns focused on four areas:

(i) growth prospects and diversification of the economy;

(ii) agricultural policy;

(iii) financing requirements of the economic recovery program; and

(iv) the social impact of the adjustment program.

3. Regarding growth prospects, several speakers pointed out the desirability of diversifying The Gambia's vulnerable economy, both through the promotion of new agricultural exports and through development of other sectors. The need to engage the private sector in the growth process, particularly in agriculture, was stressed. Enhanced regional integration and cooperation, and specifically a regional approach in fisheries development, were urged. Several speakers emphasized the need to focus on long-term constraints to growth such as environmental deterioration, rapid population expansion, and low education and health standards. One speaker, emphasizing the strategic role of transport, questioned the wisdom in the Gambian context of privatizing river transport.

4. Noting the favorable contribution of the agricultural sector to The Gambia's economic recovery in recent years, some speakers nonetheless raised questions regarding the scope for privatizing the activities of the Gambia Cooperative Union and

the Gambia Produce Marketing Board, the prospects for accelerated recovery of GCU arrears, and the likely impact of the reduction in the groundnut producer price on groundnut production and rural incomes. Regarding this last point, the staff noted that the Government could not afford to subsidize uneconomic groundnut production, and that in any case, to do so would hamper agricultural diversification.

5. The Executive Directors welcomed the increasing financial strength of the economy, both domestically and externally. They noted that a high level of financial support from the donor community is required. In particular, they welcomed the prospect of enhances structural adjustment facility resources and sought reassurance that adequate financing on appropriate terms could be mobilized either through the Special Program of Assistance for Debt-Distressed Low-Income Countries in Sub-Saharan Africa or through conventional project financing. The staff outlined the strong support of donors in the past, as well as expected cofinancing of future adjustment operations. In response to a question about the possibility of further rescheduling of debt, the staff noted that the gains from such action would be modest, and underlined The Gambia's desire to establish normal creditor relations as quickly as possible. The authorities would like to consider further rescheduling only as a fallback option.

6. Finally, the Executive Directors raised questions concerning the social dimensions of adjustment. Reassurance was sought regarding the ability of the economy to absorb unemployment resulting from civil service and public enterprise reforms. The staff noted that continuing economic growth, coupled with a specific retraining program, are expected to offset this negative aspect of adjustment. The Executive Directors also expressed the view that public expenditures for social sectors should be protected.

Mr. El Kogali made the following statement:

The Gambia is a small country whose long-term growth prospects--although constrained by its limited resource endowment--are being enhanced by consistent and determined adjustment efforts. The agricultural sector remains the main focus for economic stimulus, with emphasis being placed on the export of groundnuts and on achieving self-sufficiency in cereals. Other sectors such as fisheries, tourism, and export-oriented manufacturing also offer scope for diversification and rapid expansion of the economic base over the medium term. In adopting the Economic Recovery Program (ERP) in mid-1985, the authorities implemented comprehensive adjustment measures to halt the deterioration in economic and financial conditions and

to lay the basis for the full exploitation of the country's economic potential. The request before the Board for an arrangement under the enhanced structural adjustment facility is made to strengthen this process of adjustment.

The authorities have been successful in achieving the objectives enunciated under the ERP, supported by two arrangements under the structural adjustment facility, the second of which was approved by the Board on December 23, 1987 (EBM/87/179, 12/23/87). The growth rate in the past two years (1986/87-1987/88) averaged 5.5 percent, led by a 27 percent average rate of growth in the groundnut sector. The strong rebound in groundnut production reflected largely the response of farmers to increased price incentives and the return of favorable weather conditions. As a result, the country also experienced a modest recovery in per capita income.

In the meantime, steady progress has been made in reducing internal and external imbalances. The rate of inflation, as measured by the consumer price index, has decelerated sharply to about 9 percent at the end of 1987/88, from a peak of about 70 percent at the end of 1985/86, reflecting not only restrictive demand-management policies, but also, and perhaps more important, improvements in the supply side. The budget deficit, on a cash basis, was reduced from 22 percent of GDP in 1986/87 to 21.5 percent in 1987/88. The modest decline in the deficit masks a more substantial underlying adjustment. In 1987/88, the Government made exceptional transfers equivalent to as much as 8.3 percent of GDP to public enterprises, which involved repayment of these enterprises' debts to the Central Bank of The Gambia. This was a one-time-only operation that should not recur. These exceptional transfers, together with the delay in the disbursement of the second World Bank structural adjustment credit, resulted in an increase in domestic bank financing.

The delayed disbursement of the World Bank loan also affected the external accounts. The overall deficit was wider than projected under the program, despite a reduction in the current account deficit to SDR 31 million from a target of SDR 34 million--owing mainly to higher groundnut exports. External reserves are estimated to have increased to a level equivalent to about 2.5 months of imports in 1987/88 from a level as low as 0.2 months of imports when the Economic Recovery Program began in 1985/86. At the same time, external payments arrears were reduced by SDR 6.9 million in cash payments, in addition to payments amounting to about SDR 22 million in 1986/87.

The objectives of the 1988/89 program are, inter alia, to achieve a 4.3 percent growth rate of real GDP and to reduce further the rate of inflation to 7.5 percent. The budget

deficit, excluding grants, will be reduced to 8.3 percent of GDP. Even though external grants will be slightly lower than their level in 1987/88, the overall budgetary position is estimated to show a surplus equivalent to 1.6 percent of GDP, thereby making the Government a net creditor to the banking system. To achieve this fiscal objective, one of the major policy actions is the reduction in the amount of subsidy provided to the Gambia Produce Marketing Board (GPMB). In 1988/89, the subsidy will be reduced to D 14.4 million (representing about 1 percent of GDP) from D 130.7 million (representing 4 percent of GDP) in 1987/88. The removal of this subsidy, which involves a reduction in the producer price of groundnuts, is also being used to achieve export parity pricing. The reduction in the subsidization of groundnut production and export, together with other expenditure restraint measures, will be supported by revenue-raising actions. These include the reform of the tax law, the implementation of the new sales tax, and the procedures adopted to minimize revenue leakages from the reclassification of imports for duty purposes.

Monetary and credit targets have been formulated to support a further reduction in the rate of inflation while taking into account balance of payments objectives. To this end, the authorities have undertaken to adjust the reserve ratio requirements as may be required to absorb any possible excess in liquidity. Furthermore, to mobilize domestic savings, the authorities will continue to implement a flexible interest rate policy. The Government is also expected to extend the range of financial assets from predominantly short-term treasury bills to medium-term ones, and smaller denominations will be issued to attract a wider section of the nonbank public. The authorities are confident that, barring unforeseen developments, the quantitative benchmarks specified under the program will be satisfied.

In the external sector, the objective is to further eliminate arrears by SDR 13 million while building up reserves to SDR 32.8 million (equivalent to about 3.8 months of imports). Even though exports are projected to increase somewhat, the current account deficit is expected to remain virtually unchanged, as imports are expected to rise slightly--in line with increased economic activity--although that rise will in fact represent a reduction in relation to GDP by 1.6 percentage points.

The formulation of the current policy framework paper builds on the comments that Directors made when the second annual arrangement under the structural adjustment facility was approved in December 1987 (EBM/87/179). The programs supported by an enhanced structural adjustment arrangement should therefore help to underpin growth prospects and consolidate the

gains made thus far and thereby lead to continued increases in per capita income. Real GDP growth has been targeted at 4 percent, or slightly higher than projected earlier; the rate of inflation is projected to fall to 6 percent by the end of the program period 1990/91; and the current account of the balance of payments is expected to decline to the equivalent of 19.5 percent of GDP. With continued inflows of concessional financing, the overall balance of payments position is expected to improve considerably, and the country should be able to build up reserves to a relatively comfortable level of six months of import coverage. The latter should help to cushion the economy against unforeseen exogenous shocks while, at the same time, making it possible for The Gambia to meet all its external obligations on a timely basis.

Once again, the centerpiece of the adjustment process remains flexible management of the exchange rate, supported by price and other liberalization measures. These policies are intended to stimulate private sector activity and to improve the effectiveness of public sector investment.

To this end, attention is being given to increasing private sector participation in the traditional groundnut sector by gradually reducing the role of the GPMB through rationalization. Furthermore, the Government is restructuring agricultural credit and reorganizing the Ministry of Agriculture to achieve greater efficiency by, inter alia, removing those activities that could be better undertaken in the private sector. The industrial sector is expected to benefit from the exchange rate action and liberalization measures, as well as from the new investment code. In the fishing industry, the Government is withdrawing its direct investments and is implementing a resource management program that is transparent. Thus, the role of the Government in fisheries will be restricted to surveillance, licensing--which is being streamlined--and the provision of infrastructure, training, and credit facilities.

The reduction of groundnut prices to better align domestic producer prices to world market prices has posed a policy dilemma for the authorities. Indeed, this dilemma has implications beyond the case of The Gambia, as the solution cannot be achieved by merely adjusting producer prices in The Gambia alone. As a result of the authorities' efforts to resolve a budgetary problem through absolute cuts in the producer price, a significant price differential remains between groundnut prices in The Gambia and Senegal, even though the latter also effected similar action. In consequence, the authorities remain constrained in their goal of attracting all exports of groundnut through official channels.

The authorities are implementing specific program designed to mitigate the cost of adjustment for the most affected members of the population. Accordingly, workers who have been laid off from the public sector will receive counselling, financial assistance, and access to appropriate training through the Civil Service Resettlement Program established recently. Although it is too early to evaluate the success of the program, the authorities are hopeful that progress will be made in this respect.

In view of the foregoing factors, therefore, I would like to request Directors' support for the authorities' request for financial assistance under the enhanced structural adjustment facility and to endorse the policy framework paper.

The staff representative from the African Department said that provisional data received from the authorities indicated that at end-September 1988, The Gambia had complied with seven out of the eight quantitative benchmarks under the 1988/89 program to be supported by the proposed enhanced structural adjustment arrangement. For technical reasons, there had been a small shortfall below the target for reducing external payments arrears, as the data indicated that the external reserve target had been exceeded by more than the shortfall in the external arrears benchmark. With respect to structural benchmarks, the authorities had implemented, effective November 1, a civil service grade reform, which had been backdated retroactive to January 1, 1988. In addition, the inflation rate over the first quarter of fiscal year 1988/89 had remained moderate, at less than 1 percent a month.

Mr. Enoch made the following statement:

The Gambia's economy performed very satisfactorily in 1987--a testament to the authorities' continuing commitment to structural adjustment, backed by sound macroeconomic control. Given the very low level of per capita income in The Gambia, the strong growth in real output in 1987/88 was especially welcome. Also noteworthy were the sustained deceleration in the rate of inflation, the reduced fiscal and current account deficits, and the near doubling of foreign exchange reserves.

This encouraging macroeconomic environment allowed the authorities to implement further important structural measures, including the introduction of a new investment code, a major reform of the income tax system, further rationalization of the public enterprise sector, and continued efforts to put the groundnut sector on a more commercial footing. Perhaps most important of all, the authorities have ensured that the exchange rate system has continued to function smoothly, while interest rate and pricing policies have been commendably flexible. Such

flexibility has allowed the authorities to regain control over economic activity that was previously taking place on an increasing scale in the parallel sector.

However, despite the achievements recorded thus far under the Economic Recovery Program, it is clear that The Gambia's economy remains highly vulnerable to external shocks, is over-dependent on the groundnut sector, and is crucially reliant on concessional inflows from overseas. It is with these fundamental weaknesses in mind that Directors should assess the proposed three-year program under the enhanced structural adjustment facility.

The program rightly emphasizes the importance of continued macroeconomic prudence. The proposed sharp improvement in the fiscal deficit is particularly welcome and looks achievable, provided that the general sales tax is implemented on time and the efforts to block customs revenue leakages are successful. Implementation of the general sales tax by June 1989 is one of the structural benchmarks for the 1988/89 program. This schedule seems a little cautious, given the suggestion in the background paper that implementation will be completed by the end of the current month.

Alongside a cautious fiscal stance, it is clear that the authorities intend to maintain their tight control over monetary conditions. A number of welcome policy innovations are planned in this area, designed to lengthen the maturity of government funding and to tap the nonbank sector. The establishment of positive real interest rates has played a crucial role in the success of the floating exchange rate system, by encouraging bank intermediation of foreign exchange receipts accruing in the nonofficial sector. The continuing differential between groundnut producer prices in The Gambia and Senegal led to a further increase in the volume of unrecorded exports in 1987. As Directors heard during the Board discussion of Senegal earlier this week (EBM/88/170), one factor underpinning the price differential is the much greater marketing and processing efficiency of the Senegalese groundnut company. This discrepancy clearly underlines the importance over the medium term of increasing the efficiency of the Gambia Produce Marketing Board and injecting competition into the groundnut sector, particularly given the potential impact on rural income of further cuts in producer prices. I would be interested in any further comments that the staff might have on this regional perspective.

The importance of a prudent macroeconomic framework cannot be overstressed. However, of itself, this will not be sufficient to bring about the sustained, broadly based growth necessary to improve The Gambia's economic resilience and to reduce its dependence on concessional inflows from overseas. As the

authorities recognize, further structural measures are required in a whole range of areas. Perhaps the most important challenge facing The Gambia at the present juncture is how to promote economic diversification, particularly in agriculture. A number of significant reforms are contemplated by the authorities in this sector, but there appear to be very few measures in the program directed specifically at diversification. I would be interested to know whether the staff believes that by the end of the program period, the productive and export bases of The Gambia's economy will be significantly more diversified than they currently are.

The staff paper suggests that replacing the existing structural adjustment arrangement with an enhanced structural adjustment arrangement is designed both to support faster growth and to bolster The Gambia's relatively weak reserve position. However, a comparison of the current staff paper with previous papers suggests that the proposed enhanced structural adjustment arrangement resources are to be used almost entirely to increase foreign exchange reserves. Indeed, reserves are currently projected to rise to the equivalent of six months of imports by 1990/91, a level considerably higher than that regarded as "adequate" under the previous structural adjustment arrangement, and also substantially higher than the level considered necessary for other countries.

While the buildup of reserves will clearly improve the ability of The Gambia to cope with short-term adverse external factors, I am not sure that, in the absence of further structural adjustment and economic diversification, the economy will be any more resilient at the end of the program period than it is at present. For example, by 1990/91, the current account deficit will be no lower in SDR terms than it was in 1987, and the economy will be as precariously reliant as ever on concessional inflows. The stabilization of the current account deficit is to occur at a level substantially higher than that in other countries with enhanced structural adjustment arrangements, and at a level that raises questions about sustainability. I would be interested in whether the staff considered alternative uses of the enhanced structural adjustment facility that might have served to reduce the current account deficit, at least over the medium term.

My questioning about the optimal use of the enhanced structural adjustment facility is not intended to detract in any way from the authorities' achievements. On the basis of their strong record of adjustment and given their clear determination to pursue appropriate macroeconomic policies and structural reforms over the program period, I fully support their request for an enhanced structural adjustment arrangement.

Mr. Yao made the following statement:

The economic performance of The Gambia has been impressive over recent years. Economic activity has grown at a strong pace; the rate of inflation, as measured by the consumer price index, has subsided; the internal and external imbalances, although relatively large, have been reduced significantly; and the structural benchmarks under the second structural adjustment arrangement were observed satisfactorily. I commend the authorities for these achievements, as they reflect the authorities' commitment to the adjustment process.

Despite the progress made, I agree with the staff that the economic and financial situation in The Gambia is still vulnerable to external factors. In this respect, I welcome the authorities' willingness to pursue their adjustment efforts, as spelled out in the new policy framework paper covering the period 1988-91. The main objective of promoting growth under conditions of sound financial management seems appropriate, and the underlying economic strategy to achieve this objective merits financial support under the enhanced structural adjustment facility.

The continuing reform in the real sector, particularly the rationalization of the groundnut subsector, is welcome. In view of the downward trend of the groundnut export price, the flexible producer price being implemented is appropriate. That approach will contribute to reducing the deficit of the Gambia Produce Marketing Board (GPMB). Also, the study to be undertaken with a view to further improving the efficiency of the GPMB is a step in the right direction, and its prompt implementation would be desirable. Recent steps to reduce arrears on outstanding agricultural credit and the establishment of new credit guidelines will reinforce the creditworthiness of the groundnut sector, thereby improving its long-term growth prospects.

It is encouraging that the role of the private sector in the economy is being enhanced. In this connection, I note with interest that the Ministry of Agriculture will be streamlined to encourage the private sector in the marketing and provision of agricultural inputs. In the fishery sector, the Government has discontinued its investment in an effort to attract private participation. The new investment code is favorable to the development of the private sector. I am confident that these actions will lay the foundations for a long-term growth.

Commendable efforts have been made to contain the budget deficit, but as that deficit as a percentage of GDP remains high, the Government's objective of reducing it much further over the coming years is encouraging. While I welcome the

authorities' efforts on the revenue front, which will increase the efficiency of the tax system and curtail tax evasion, the fiscal deficit objective can be achieved only through a significant reduction in expenditure. In this respect, I welcome the authorities' decision to eliminate subsidies by adopting more flexible pricing policies and by increasing efficiency in all sectors of the economy. Given the authorities' good track record on program implementation, I support their request for an enhanced structural adjustment arrangement.

Mr. Ismael made the following statement:

I am in broad agreement with the staff appraisal and The Gambia's request for arrangements under the enhanced structural adjustment facility. I support the proposed decisions.

The authorities are to be commended for their commitment to implementing their Economic Recovery Program. It is gratifying to note that their perseverance has brought about further economic progress and the attainment during 1987/88 of most of the targets of the program supported by a structural adjustment arrangement.

However, as is normally the case, many more problems remain to be tackled: the economy still needs to be diversified; groundnut production subsidies have to be phased out; the inflation has to be reduced further; the continuing large budget deficits have to be curtailed further; the external current account deficit in relation to GDP has to be narrowed; international reserves have to be increased further; and the remaining external payments arrears have to be eliminated. Therefore, I welcome the authorities' request for arrangements under the enhanced structural adjustment facility, in order to continue and strengthen their adjustment efforts of the past two years under the program supported by the structural adjustment facility. Given the authorities' good track record of implementing strong adjustment measures since mid-1985, and the strength of the proposed program, I am confident that the enhanced structural adjustment arrangement will facilitate The Gambia in achieving its medium-term objectives.

I agree with the staff on the importance of further price liberalization for removing the remaining impediments to growth especially in the agricultural sector. The reduction in the domestic producer price of groundnuts is most welcome, as it is the most important commodity in The Gambia. This measure--together with other reforms envisaged under the program, such as the reform of the agricultural credit system--will help to improve the medium-term growth prospects of the agricultural sector, as well as to reduce public expenditures.

The introduction of a uniform 10 percent general sales tax and the reform of the income tax law, as recommended by the Board at the conclusion of the Article IV consultation in 1987, represent welcome efforts to generate additional revenues. The reduction in subsidies for public enterprises, to improve their financial footing, should especially be intensified as a means of restraining public expenditures. The prevailing plan to reduce groundnut subsidies is therefore most welcome; and, I urge that the target reduction should be adhered to as closely as possible.

As the staff recommends, a continued prudent approach to monetary policy is needed. Therefore, I welcome the appropriate implementation of a flexible interest policy, as adopted in 1986, and the maintenance of positive real interest rates to enhance domestic savings.

Given The Gambia's resource endowment and small domestic market, I agree with the staff that the authorities should continue their efforts to diversify the export base and to expand fishing, tourism, and entrepôt trade activities, while maintaining the flexible exchange rate policy practiced since January 1986 in order to avoid the materialization of Scenario B, depicting a situation of lower real exports combined with higher import prices. In view of the recent appreciation of the dalasi, the authorities should monitor these developments closely.

As is the case with many developing countries, The Gambia's growth-oriented adjustment program will also require adequate and timely concessional financial support from donor countries. Given the positive strides made by The Gambia in its adjustment efforts, and the Government's determination to strengthen these efforts further with a strong program supported by the enhanced structural adjustment facility, and its desire to establish normal creditor relations as quickly as possible, I am confident that The Gambia will receive the necessary concessional financial support from the international donor community.

Mr. Goos said that he agreed with the staff that the implementation of structural and financial policies under the adjustment program over the past two years had been quite encouraging; substantial progress had been made in all key areas. Nevertheless, there was obviously still much to be achieved, and vigorous implementation of the policies under the proposed enhanced structural adjustment arrangement was indeed warranted.

As he had pointed out at the discussion of the 1987 Article IV consultation with The Gambia (EBM/87/127, 8/31/87), the appropriateness of the pace of external adjustment was a cause for concern, Mr. Goos observed. Notwithstanding the better than programed performance of the

current account in 1987/88, the envisaged reduction of the current account deficit by some 4 percent of GDP by 1990/91 did not look overly impressive, particularly considering the substantial size of the current account deficit. And even though he certainly agreed that the external financing prospects looked quite encouraging from a current perspective, and that it was certainly tempting to exploit those prospects to the fullest extent possible, it was generally advisable--given the external risks revealed by the staff's sensitivity analysis--to err on the side of caution in formulating the adjustment/financing mix. A more ambitious approach to external adjustment might somewhat constrain short-term growth performance; but, in the circumstances of The Gambia, it did seem that achieving the laudable objective of improving the living standards of the population on a sustainable basis would be possible only if assisted by determined efforts to reduce what, even by African standards, was a very high rate of population growth. He therefore welcomed the authorities' commitment to family planning and encouraged them to move ahead vigorously in that area.

The substantial slippage in reducing external payments arrears in 1987/88 was a cause for concern, and was heightened by the staff representative's information that there had been a renewed shortfall in meeting the arrears target, and by the fact that at the previous Board discussion of The Gambia, several speakers, including himself, had recommended a more ambitious reduction of those arrears than envisaged under the program, Mr. Goos emphasized. Given the critical importance of normalizing creditor relations, the authorities should pursue the reduction of external arrears as a matter of priority.

The impressive fiscal effort envisaged should go a long way toward stabilizing the domestic and, he would have thought, the external situation, Mr. Goos considered. However, in the latter respect, it was somewhat puzzling that the strong fiscal adjustment was not expected to show up in any tangible improvement in the external current account position. The staff could usefully comment on the matter.

The authorities should increase their efforts to diversify production and exports in view of the continued high vulnerability of the external position, an area in which the program might have been somewhat more specific, Mr. Goos stated. It appeared that uncoordinated regional agricultural pricing policies could continue to hamper the objective of achieving diversification; therefore, the staff should address the issue of interregional production and trade relations in a more explicit and policy-oriented manner in its future reports, as he had suggested with respect to Senegal. He agreed with the staff appraisal and supported the proposed decisions.

Mr. Serre made the following statement:

> This chair commends the authorities for the progress made under the Economic Recovery Program, adopted in 1985. The decisive turnaround achieved demonstrates how a comprehensive adjustment program can address imbalances in an economy and

produce good results when the authorities are committed to its implementation. It is gratifying that The Gambia is able to take advantage of the enhanced structural adjustment facility, because my authorities attach great importance to timely implementation of the facility. The medium-term strategy envisaged under the program supported by an enhanced structural adjustment arrangement is a continuation of the measures already in place. In particular, it is worth noting that the main adjustment measures, such as restoring normal debtor-creditor relations, introducing a flexible exchange rate system, implementing prudent credit policies, and maintaining a flexible interest rate policy are well on track.

It is clear now that structural policies are of the utmost importance for maintaining the gains made already. The Gambia's economy remains vulnerable, owing to the importance of groundnut production in the process of growth. In this connection, I welcome the groundnut producer price policy envisaged beyond the program to alleviate budgetary transfers. However, it is necessary to increase the diversification of The Gambia's economy through the promotion of new agricultural exports and through the development of other sectors such as fisheries, tourism, and trade services. The authorities should also pursue the privatization of the agricultural marketing institutions and strengthen public enterprise reform by implementing timely performance contracts.

Taking into account developments in previous years, I am confident of the authorities' ability to improve the economic environment by contributing to broadly based growth. Moreover, The Gambia deserves to receive support for maintaining basic social services, despite the pressing constraints arising from the high population growth rates. I hope that The Gambia's structural reforms and adjustment efforts will be supported by external donors.

The authorities are to be commended for their willingness to implement prudent demand-management policies, particularly in the fiscal budget area, to strengthen monetary policy, and to improve the external position through an appropriate exchange rate policy. I endorse the staff's recommendations on the exchange restrictions, aimed at eliminating external arrears by the end of the program.

The Gambia's adjustment program provides a good example of the benefits of disciplined financial and monetary monitoring in conjunction with a well-managed exchange rate policy. I strongly support the authorities' request for an enhanced structural adjustment arrangement.

Mr. Rieffel made the following statement:

The contrast between the economic and financial situation in The Gambia and that of Senegal, which Directors discussed at the previous Board meeting (EBM/88/170), is most interesting. The shorter length of my remarks on this occasion should not be taken as an indication that my chair is less interested in the progress made by The Gambia in addressing its economic difficulties. The authorities of The Gambia are to be commended for their success since 1985 in correcting the severe imbalances that had emerged.

The emphasis in the program for 1988/89 on improving the operations of the Gambia Produce Marketing Board, and especially on the possibility of privatizing its operations, is welcome. I hope that the staff will help to ensure that The Gambia's experience in this area is shared with neighboring countries facing similar challenges. In this connection, the elimination of the subsidy for groundnut production in fiscal year 1989/90 is especially important.

The Gambia's fiscal policies are also impressive, especially the 27 percent reduction in expenditure envisioned over the next three years, as is the pace of reform in the parastatal sector, both in divesting enterprises and in negotiating performance contracts.

With respect to the regional context of The Gambia's adjustment efforts, I wondered in reviewing the staff paper whether The Gambia's success was coming to some extent at Senegal's expense. The staff could usefully comment on the compatibility of the two countries' policies and on the impact of those policies on groundnut production, trade liberalization, and capital movements.

The rationale provided by the staff for the proposed level of access is not fully convincing. Access at 100 percent of quota instead of 120 percent might have been more appropriate. The buildup in reserves to six months of imports seems excessive; and, by the same token, a faster reduction of external arrears could have been justified. Even though The Gambia's adjustment program is certainly a strong one, I do not see a balance of payments need that justifies increasing outstanding Fund credit to The Gambia over the next three years.

To reiterate my chair's previous requests, the inclusion of structural performance criteria in all enhanced structural adjustment and extended Fund arrangements would be useful, as would be an assessment of a member's capacity to repay in all staff papers on requests for the use of Fund resources. It is gratifying that the staff paper refers explicitly to the

capacity to repay both in the discussion of medium-term scenarios and in the staff appraisal, but I would hope to see a paragraph or two explaining the staff's assessment, instead of just a simple assertion of a member's capacity to repay.

The authorities are to be commended for their excellent track record, and I support the proposed decisions, with the small qualification that I expect The Gambia to eliminate its multiple currency practice before the end of the 1989/90 fiscal year.

Mr. Rouai made the following statement:

The Gambian authorities' firm intention to persevere with their macroeconomic and financial adjustment in the context of an enhanced structural adjustment arrangement is welcome.

The Gambia has come far since the adoption of the Economic Recovery Program in 1985. The authorities have been successful in reversing the severe trend toward economic decline, and in improving real per capita income. They have also been able to achieve most of the objectives set under the structural adjustment arrangement, thanks to the implementation of prudent fiscal and monetary policies, supported by the introduction of a floating exchange rate system. In this respect, I especially welcome the sizable decrease in the inflation rate, the improvement in the balance of payments position, the building up of foreign reserves, and the steady reduction in external arrears.

The authorities are to be commended for their courageous implementation and continuing adherence to structural reforms, which will help to further liberalize the economy and to reduce internal and external imbalances. The staff, and Mr. El Kogali in his opening statement, have pointed out that the authorities are committed firmly to pursuing the reforms described in the policy framework paper and have already implemented some of the planned measures. I therefore warmly support The Gambia's structural adjustment program, and agree broadly with the staff appraisal.

The emphasis on institutional reforms and on the rationalization of the groundnut sector are welcome. While I have noted the staff's focus on pricing policies and have no quarrel with that approach, more attention should be paid to investment, particularly rehabilitating infrastructure in rural areas, improving productivity in the groundnut sector, and diversifying production and exports. Furthermore, if the producer price of groundnuts continues to fall, The Gambia's rural population will be affected adversely, since groundnut production constitutes the main source of its income. As my chair stated in the case

of Senegal (EBM/88/170), it is a cause for concern that the growth of groundnut production will be put at risk in the future by further declines in the producer price.

The continued implementation of a flexible exchange rate policy and the elimination of the differential between the interbank and parallel market rates are welcome, and I appreciate The Gambia's efforts to reduce payments arrears and to normalize relations with external creditors. However, I have some concerns about the country's heavy debt service, as it could jeopardize the pace of the adjustment program; and I note the persistence of large current account deficits, even at the end of the program. As a consequence, the prospects for growth will be hampered if more highly concessional assistance from the international community is not channeled to the country on a continuous and timely basis.

While I am comforted by the modest gains in real per capita income, certain measures, such as increases in prices and public sector layoffs, might drastically affect the poorest segment of the population in The Gambia, which remains among the poorest countries in Africa. Means should be found of mitigating whatever transitory negative effects might emerge. In this respect, I welcome the establishment of the Civil Service Resettlement Program and the authorities' initiative to conduct a nationwide survey of living standards to assess the socio-economic effects of the adjustment process. I support the proposed decisions.

Mr. Al-Jasser made the following statement:

The Gambian authorities are to be congratulated for persevering in their efforts to restructure the economy and thereby to reinvigorate growth through more efficient allocation of public and private resources.

Since the adoption of the Economic Recovery Program in 1985, the economic achievements of The Gambia are impressive indeed. The successful twin liberalization of the exchange rate system and interest rate policies, coupled with the effective dampening of inflationary pressures, is exemplary. Bringing down the inflation rate from 22.3 percent to 9.2 percent while achieving real GDP growth of 5.5 percent in 1987/88 is heartening. True, God's help in the form of better weather conditions during the past two years and that of external donors and lenders in the form of grants and concessional loans made these achievements possible; but, nevertheless it seems that it was the authorities' determined efforts to implement the necessary reforms that made these positive results realizable.

Mr. El Kogali's opening statement is most helpful in demonstrating the comprehensiveness of the authorities' efforts to attain such results.

It is commendable that the authorities met the targets and benchmarks under the second structural adjustment arrangement, particularly in the areas of GDP growth, current account balance, fiscal policy, and public enterprise reform. The latter seems deservedly to be getting the authorities' utmost attention, owing to its influence on the allocative efficiency of the economy, and on the fiscal stance of the Government. The authorities' conclusion of performance contracts with nonfinancial enterprises is an innovative means of institutionalizing allocative efficiency and accountability in public and semi-public enterprises.

As spelled out in the request for an enhanced structural adjustment arrangement, the reforms--implemented or to be implemented by the authorities in the public investment program, civil service, tax system, and government expenditure areas--are far-reaching and merit Directors' support. Cutting government current expenditures by 27 percent in three years through the rationalization of subsidies and transfers to parastatals, while enhancing the efficiency of government investment expenditure and reducing inflation is a feat that Directors should encourage. However, shielding the poor so that they do not bear a disproportionate share of the burden of the restructuring process is of paramount importance.

I agree with the thrust of the staff paper and appraisal, and commend the authorities for their efforts while encouraging them to pay due attention to the precariousness of their external and internal balances, which are dependent on external transfers. Diversifying The Gambia's productive base, including production for export, is of crucial importance for the viability and sustainability of the country's development aspirations. In this respect, I would appreciate staff comment on the contribution of the financial sector to mobilizing private savings and productive investment at the current juncture, when the spread between bank deposit and lending rates is sizable. I support the proposed decisions.

Mr. Othman made the following statement:

The Gambian authorities are to be commended for their further progress under the program supported by the structural adjustment facility. The policies pursued under the first and second structural adjustment arrangements have contributed significantly toward the consolidation of the gains achieved under the Economic Recovery Program, which began in mid-1985.

It is clear however that more needs to be done, as The Gambia continues to face serious economic imbalances. The Gambia's external payments position remains vulnerable and heavily dependent on official transfers and concessional borrowing. External debt as a ratio of GDP is not expected to decline significantly during the course of the program from its current high level. The servicing of the external debt will therefore continue to absorb a large proportion of available resources, especially during the first two years of the program. Also, the large size of the budget deficit will require the authorities' determined efforts on both the revenue and expenditure sides of the fiscal budget if the objectives of the three-year program are to be achieved.

The producer price for groundnuts was reduced by 17 percent during 1987/88, and an announcement has been made that a further downward adjustment of about 27 percent will be effected this year. While I understand the rationale behind the adjustment, the impact of the price cut on production should be assessed carefully, given the high elasticity of groundnut production to prices, as pointed out by Mr. El Kogali in his opening statement. I have noted the adverse effect of this price decrease on rural income, and thus that it runs contrary to the aim of the recovery program. However, it is encouraging that the authorities are taking certain positive steps to minimize the social costs of the price adjustment.

The budget deficit is expected to be reduced by the equivalent of 13.2 percent of GDP in 1988/89, an objective that appears to be somewhat ambitious. While I recognize that such a reduction will be made possible mainly in view of the high level of concessional borrowing from the international community, more domestic action on both the expenditure and revenue sides of the fiscal budget is needed. In this respect, I welcome the authorities' initiatives to expand the tax base and to improve the efficiency of the tax collection process.

The projected pace of reduction of the current account deficit for the next five years is slow. The current account deficit for 1988/89 is projected to be virtually unchanged from its 1987/88 level. While this is understandable in view of the great external vulnerability of the Gambian economy, efforts should be intensified to expand and diversify the production base in order to achieve a viable external position and to attain the program targets for external arrears and reserves. In this connection, it is encouraging to note that the financing requirements over the program period will be adequately met.

It appears that the authorities' undertakings for the years ahead--given their previous good performance--will be implemented effectively, and will constitute further important steps

toward attaining internal and external viability. As noted by the staff, the success of the program will also depend on the timely and appropriate provision of external financial support. I support the proposed decisions.

Mr. Binay said that he agreed broadly with the staff appraisal and supported the proposed decisions.

In view of the protracted nature of The Gambia's problems, its future depended greatly on increasing the efficiency of existing institutions and on building up the institutions that were necessary for establishing a sound economic and social basis, but that The Gambia lacked, Mr. Binay stated. The estimated gains in efficiency on which the staff's medium-term scenario was based were spread over a wide array of sectors, from the Gambia Produce Marketing Board to the administration and collection of taxes and to public expenditure control. However, since no utopian or even dramatic changes for improving the current state of production technology were predicted, the estimated increases in efficiency were evidently expected to come exclusively from increase in labor productivity, and, even more important, from the enhancement of managerial and administrative skills at the higher echelons of the Government.

Given the disincentives coming from the current wage policy, he wondered to what extent such increases in efficiency were achievable, Mr. Binay commented. Public and private sector wages increased by nearly 2 percent between 1982 and 1987, while inflation rose by over 300 percent during the same period, representing a real wage decline of 67 percent. Were wages in 1982 unsustainably high, so that current relative prices reflected the long-run equilibrium in the labor market? Did wage and salary earners seek and easily find second jobs in the informal sector? Were other means of redistributing income involved? Directors had to take into account that any recovery, no matter how painfully achieved through structural changes, would be short-lived if it provided no incentives for people to replace the old system with a new one promising to lead to an improved social environment.

Mr. Morita welcomed the authorities' successful adjustment efforts under the Economic Recovery Program since mid-1985; they had made remarkable progress.

Supported by external resources, The Gambia's medium-term prospects did not seem to be a serious cause for concern, although its economic position was still very vulnerable, as evidenced by the external arrears and the heavy dependence on external assistance, Mr. Morita continued. Moreover, the external current account deficit, excluding grants, was still projected to be equivalent to about 20 percent of GDP over the whole program period. It was therefore clear that the authorities should continue their adjustment efforts strongly to avoid any program slippages;

and, if the need arose, they should not hesitate to take additional measures. At the current stage, a gradualistic approach to adjustment was not yet warranted.

It was encouraging that a sharp reduction in the fiscal deficit was projected, along with a sharp decline in subsidies and transfers, Mr. Morita remarked. At the same time, personal emoluments were expected to rise substantially in 1989/90, and were projected to grow during the succeeding two years at almost the same rate as the GDP deflator--which was exceeding the increase in consumer prices--leading to a steadily increasing share of such spending in total fiscal expenditure and net lending. He had some doubts about whether the rise in personal emoluments was appropriate. In any event, the authorities' intention of implementing fully the new sales tax was welcome, and he saw ample scope for strengthening tax administration.

The projected growth of exports was a little optimistic, especially under Scenario A, Mr. Morita considered, while he noted that rapid import growth was expected in reflection of strong economic activity. Much of the adjustment of the external position in terms of GDP depended on the pickup of groundnut production, with the background paper suggesting that the rebound of groundnut output during the past year had been due not only to the return of favorable weather, but also to the extension of acreage under cultivation, induced by a higher domestic producer price. He wondered whether the projected increase in groundnut production would continue to be obtainable in view of the lower groundnut prices, arising from the sharp cut in the groundnut subsidy.

Table 4 in the staff paper showed that the deficit on "other services" was projected to remain virtually unchanged, while substantial growth was expected in the travel income surplus, Mr. Morita observed. Even though he was unsure why the "other services" deficit would remain unchanged, the authorities should make every effort to reduce that deficit, if scope for such action existed.

Early settlement of external arrears was important, and it was essential that the authorities vigorously seek to mobilize further external resources from the international financial community, Mr. Morita emphasized. The building up of foreign reserves to a favorable level to protect the external position from exogenous shocks was useful, and he understood that resources from the enhanced structural adjustment facility would not be used directly for that purpose. He supported the proposed decisions.

The staff representative from the African Department said that a major part of the sales tax had been implemented already, namely, the replacement of the import tax at the manufacturer and importer level. The remainder of the sales tax would be phased in, to include restaurants, hotels, casinos, and other services, a phasing in that would necessarily

be gradual because of resistance by the latter sectors. The staff hoped that most of the remaining sectors, if not all, would be covered by the end of the fiscal year.

The staff had not discussed the regional aspects of policy vis-à-vis Senegal, referred to as the "contiguous country" in the staff paper, the staff representative pointed out. Aspects such as the two countries' policies with respect to fishing surveillance could possibly be discussed; but it would be most difficult for the respective governments to discuss an appropriate producer price policy for groundnuts, and even harder for the Fund to intervene in that highly sensitive area.

Without getting into the question of whether The Gambia's successful performance had come at the expense of Senegal, the staff representative noted that The Gambia had certainly benefited from the latter's policies over the past two years, particularly owing to Senegal's higher groundnut producer price. And, with an appropriate exchange rate policy in place by 1986/87, The Gambia had been able to export groundnuts through Senegal. Its farmers had received CFA francs in return that were then repatriated through the banking system. In fact, The Gambia had benefited in two ways from Senegal's policy of having higher groundnut producer prices: by earning greater foreign exchange earnings than otherwise would have been possible, as Senegal's producer price was higher than the world market price; and by its reduced need for a groundnut subsidy for each unit sold in Senegal. In 1987/88, those factors had been even more favorable to The Gambia, as the spread between the two countries' groundnut producer prices had widened--owing to the 16-17 percent reduction in The Gambia's groundnut producer price--enabling The Gambia to export even more through Senegal and thereby to earn increased foreign exchange and to reduce further the groundnut subsidy. Moreover, farmers in The Gambia had earned more than in the previous year.

With respect to increasing the efficiency of the Gambia Produce Marketing Board over the medium term, most of the targets for cost savings under the first performance contract introduced in 1987/88 had been met, the staff representative continued. To reduce the wage bill, the contract emphasized greater reliance on "daily labor" versus regular staff, and called for the greater utilization of equipment in the processing mill. Cost savings achieved in 1987/88 and those expected to occur in 1988/89 were some of the reasons why the current program projected a reduction in the groundnut subsidy from D 50 million--about 4 percent of GDP in 1987/88--to D 13 million in 1988/89.

Even though economic diversification over the medium term would not be substantial, it should still be sufficient in the areas of horticulture, fisheries, and other cash crops to make the production and export targets under the program realizable, the staff representative stated. To achieve the diversification objectives, the authorities were relying on maintaining both an appropriate exchange rate and financial environment, instead of changing producer prices or of intervening directly in various subsectors, which they currently did very little. Furthermore, support

services for the entire agricultural sector would generally be increased, and other measures related to the diversification study might be introduced. In any event, the diversification and output objectives of the program were moderate. After discussions with the authorities and knowledgeable observers in the private sector, the staff was projecting growth on a sustained basis of minimally less than 4 percent a year over the medium term, or an increase in per capita income of about only 1/2 percent a year. The 5 1/2 percent rate of growth achieved over the past two years reflected a rebound after a period of stagnation or decline. Nevertheless, even if the relatively moderate diversification and output objectives were met consistently, it could not be denied that the Gambian economy would still be very vulnerable at the end of the program period.

In Scenario A, or the baseline scenario of the program, the staff had projected sustained growth of groundnut exports of 2 1/2 percent a year over the medium term, based exclusively on productivity gains, such as through the use of better seeds and fertilizers, the staff representative explained. The 6.9 percent increase in the volume of those exports recorded in 1987/88 was not necessarily due to any increase in the level of production, but to the widening of the producer price differential with Senegal. The staff was being conservative in projecting the outturn for 1988/89, in that it was deliberately not taking into account the scope for increased unrecorded groundnut exports to Senegal that would arise from the further widening of the producer price spread.

The forecast reduction in the central government deficit would not be mirrored by a decline in the external deficit because the former reflected, mainly, bookkeeping transactions, the staff representative observed. The expected reduction in that fiscal deficit for 1988/89 was almost entirely due to the nonrecurrence of the repayments of the large debts of the two main public enterprises in 1987/88 to the Central Bank. These transactions had no effect on the money supply, on demand in general, and therefore none on the external accounts. Thus, the effects of the reduced budget deficit in 1988/89 would not be the same as they would be if such a pronounced fiscal adjustment were to take place through raising fiscal revenues or scaling back expenditures.

The staff had believed since the beginning of the Fund-supported program in 1986/87 that the public sector was overmanned, the staff representative commented. A major program objective had been to reduce the number of civil servants, which the authorities had very courageously done by about 18-20 percent, albeit mainly lower-paid workers. The idea had been and still was that the resulting savings in wage costs would be used to increase the wages of more productive workers having greater responsibilities. Further to that effect, on November 1 of the current year, the authorities had implemented the new civil service grade scale. Within the overall budget ceiling for personal emoluments for 1988/89, preliminary information indicated that the changes in the scales would not greatly increase the wage bill, but the deferred general wage and salary increase would. The latter would probably become effective close to March

1989, and would likely be backdated slightly. Nevertheless, a rise in personal emoluments was necessary to provide adequate incentives, and especially to help the authorities sustain their adjustment effort with reduced reliance on expatriate help.

The shortfall in the arrears reduction in 1987/88 was more than accounted for by the delay in concluding the second World Bank structural adjustment credit, the staff representative noted. As pointed out during the Executive Directors' discussion at the World Bank the previous week and in the policy framework paper, many studies had to be undertaken by both the authorities and outside consultants with respect to some of the structural measures to be included under the second World Bank structural adjustment credit. Moreover, many technical assistance projections had to be put in place. In general, the delay had not been because of any policy shortcomings on the authorities' part.

Irrespective of any numbers that the staff could show, the expected improvement in The Gambia's medium-term balance of payments prospects and debt service capacity, and thereby in its ability to service its financial obligations to the Fund, was predicated on the strength of the authorities' adjustment effort and their continued commitment to sustaining it, the staff representative emphasized. That was the main safeguard of The Gambia's ability to service its financial obligations to the Fund. The staff had dealt with the issue in several places in the staff paper. For instance, on page 9 it was mentioned that the program aimed at reducing the ratio of the external current account deficit to GDP and at maintaining an appropriate debt profile to achieve declines in both the external debt service ratio and ratio of debt to GDP, and that the program aimed at accelerating the buildup of external reserves to the equivalent of six months of imports by 1990/91. Page 18 included a balance of payments sensitivity analysis, and mentioned that The Gambia was maintaining its arrangements to acquire SDRs in anticipation of meeting its financial obligation to the Fund, and that its recent payments record to the Fund was commendable. Moreover, reasons had been provided in the staff appraisal for why The Gambia would have the capacity to meet its financial obligations to the Fund in a timely manner. Even though The Gambia's outstanding use of Fund credit was projected to rise to 189 percent of quota in 1991, it was expected to decline thereafter to only 19 percent by the end of the ten-year period ending in 1997/98. Furthermore, the Fund's share in The Gambia's total debt would rise to about 13 percent over the next three years, but would decline subsequently to a very small share, or somewhat less than 6 percent by the second half of the 1990s. More important, during the late 1990s, when The Gambia's repurchases of resources borrowed under the structural and enhanced structural adjustment facilities would be made, its ratios of debt service payments to exports and to reserves were expected to fall to less than 6 percent and 8 percent, respectively. With those details in mind and given the low ratios involved, the staff had felt that it was unnecessary to give a more formal presentation of The Gambia's repayment capacity.

Interest rates were positive in real terms, with the treasury bill rate at about 17 percent compared with the inflation rate of approximately 9 percent, the staff representative from the African Department added. Real positive interest rates had been instrumental in the increased monetization of the past two years. The latter was beginning to be accompanied by an increasing share of time and savings deposits in broad money, the ratio having increased by a substantial 3 percentage points or so over the past year. With respect to whether investment would be inhibited by high real interest rates, he noted that, as in most developing countries, investment projects per se were not financed by the commercial banking system. Even though The Gambia was to have a small-scale enterprise development project offering loans through the commercial banks at lower interest rates, that project was to be under the auspices of the World Bank. Commercial activities, as distinguished from investment projects, were financed by the domestic commercial banking system; and, given the spread in interest rates, much of the commercial activity was financed from abroad, which was why The Gambia had maintained a surplus in its external private capital account over the past two years.

The staff representative from the Exchange and Trade Relations Department said that the most recent policy framework paper and the current staff paper indicated that, for the three years from 1988/89 to 1990/91, the current account deficits in SDRs or in absolute terms would be quite small and less than those projected in the previous policy framework paper. Moreover, the capital account surplus envisaged for those three years was larger than projected under the previous policy framework paper. The resulting larger than foreseen balance of payments surplus, as opposed to the proposed use of resources under the enhanced structural adjustment facility, was expected to contribute to the programmed reserve buildup. The latter should be considered in light of the two medium-term balance of payments scenarios projections, showing that the overall balance of payments position was highly vulnerable and uncertain; indeed, as shown on page 17 of the staff paper, the reserve levels under the two scenarios were starkly different, one at six months of imports by 1992/93, the other at only 1.7 months of imports by that time. In that connection, the staff believed that the planned reserve buildup during the next three years was appropriate, as it did not want the program to be jeopardized by insufficient reserves during a time when it expected that the policies geared toward diversification would be implemented. With diversification, the current account deficit would turn out to be lower in the long run, but that could not be said with certainty for the shorter run, especially if foreign resources were flowing in and were being used to diversify gradually production and exports.

To sustain a strong policy package, particularly in the short run, access of 120 percent was preferable to 100 percent access, the staff representative remarked. Access under the enhanced structural adjustment facility was flexible and could be reconsidered, but grave problems would arise if access was lowered in an effort to reduce the planned rate of reserve accumulation. Without the latter, in the event of exogenous shocks, the program might go off track right at the beginning; thus, a

year or two should pass to allow the new policies to take hold before the current access levels were reconsidered. In any event, current access was not, in itself, contributing to the buildup of reserves; the projected balance of payments surpluses, after paying off arrears, would still allow the reserve accumulation.

The staff representative from the African Department added that, in an environment of extensive trade controls in the mid-1970s, reserves had approached eight months of imports. In the completely liberal exchange system that existed currently, the reserve target of six months of imports seemed appropriate.

Mr. El Kogali noted the staff's comprehensive replies and said that he would convey Directors' encouraging comments to the authorities.

The Acting Chairman said that perhaps another assumption should have been made explicit with respect to The Gambia's ability to meet its financial obligations to the Fund, which was that donors and creditors should not resist repayments by the country when the time for repurchases came.

The Acting Chairman made the following summing up:

> Directors were in broad agreement with the appraisal in the staff report. They noted with satisfaction that The Gambia had continued to adhere to the policies under its program supported by a structural adjustment arrangement and that most of the key objectives for 1987/88 had been achieved. Directors cited the further economic expansion, deceleration in inflation, and buildup of foreign reserves. These developments were associated in large measure with the implementation of fiscal policy broadly as planned. The restrained credit policy also contributed to these developments, as did the flexibility of interest rates and the continued smooth functioning of the floating exchange rate system.
>
> Directors observed that, despite broadly based improvements over the past two years, The Gambia's external payments position remained vulnerable, which clearly called for efforts to accelerate economic growth and diversification and to strengthen further the external current account through the continued vigorous implementation of structural adjustment, including supply-side, policies. They agreed with the authorities' emphasis on continuing appropriate exchange rate, interest rate, demand-managements, and external debt and reserve policies, and also noted in this context the programmed sharp curtailment of the budget deficit. They welcomed the policy framework paper for the 1988/89 to 1990/91 period, and The Gambia's request for arrangements under the enhanced structural adjustment facility. Directors observed that in view of The Gambia's low per capita income, the worrisome pace of population growth, and

The Gambia's continued vulnerability to external developments, it was essential that the authorities implement effectively their planned structural policy reforms while attempting to protect lower-income groups. Directors viewed as appropriate the focus on promoting growth in agriculture, fisheries, and tourism, continued reform of the public enterprises, stepped-up government divestiture of holdings, and also efforts to improve the allocative efficiency of government expenditures.

In assessing the authorities' program for 1988/89, Directors supported the planned curbing of the subsidy in respect of groundnut operations and its eventual elimination, and emphasized the need to improve the marketing and processing efficiency of the Gambia Producer Marketing Board. They also cautioned that strong efforts would be required in other areas, in particular, to implement the civil service reform and the long-delayed public sector wage and salary adjustment. On the revenue side, importance was attached to the need to administer effectively the reformed income tax law, to implement promptly the new sales tax, and to minimize revenue leakages.

Directors noted that the monetary and credit program for 1988/89 reflects a further financial deepening in the economy and the targeted increase in the net foreign assets in the banking system. They stressed, however, that the authorities should closely monitor monetary expansion and be prepared to further tighten the program's credit policy if this were to become necessary for achieving the program's inflation rate and external objectives, including the accumulation of foreign reserves.

The authorities were urged to accelerate the liquidation of external payments arrears and to restore normal relations with The Gambia's creditors. Directors believed that The Gambia's policies continued to merit the support of the international community, particularly in the form of grants and concessional flows.

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

The Executive Board then took the following decision:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to The Gambia's exchange measures subject to Article VIII, Sections 2(a) and 3, in concluding the 1988 Article XIV consultation with The Gambia, in the light of the 1988 Article IV consultation with The Gambia

conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The exchange restrictions evidenced by the commercial external payments arrears and a multiple currency practice arising from the cost of domestic currency counterpart deposits required of purchasers of foreign exchange prior to the payment of external obligations in arrears maintained by The Gambia are subject to Fund approval under Article VIII, Sections 2(a) and 3, respectively. The Fund notes the intention of the authorities to remove these restrictions and the multiple currency practice as soon as possible, and, in the circumstances of The Gambia, the Fund grants approval for their retention until November 22, 1989, or the conclusion of the next Article IV consultation with The Gambia.

Decision No. 9026-(88/171), adopted
November 23, 1988

Enhanced Structural Adjustment Arrangement

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

2. The Fund notes the updated policy framework paper for The Gambia set forth in EBD/88/289.

3. The Fund approves the arrangements set forth in EBS/88/214, Supplement 2.

Decision No. 9027-(88/171), adopted
November 23, 1988

## DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/170 (11/21/88) and EBM/88/171 (11/23/88).

## 4. ENLARGED ACCESS POLICY - EXTENSION AND ACCESS LIMITS FOR 1989

The Fund, having reviewed the Decisions on the Policy on Enlarged Access and the limits on access to the Fund's resources under that Policy and under the Buffer Stock Financing Facility

of the Fund, and confirming that the Policy on Enlarged Access will be reviewed in light of the outcome of the Ninth General Review of Quotas, decides that:

1. In paragraph a. of Decision No. 7599-(84/3), as amended, "1988" shall be replaced by "1989."

2. (a) In the third sentence of paragraph a. of Decision No. 7600-(84/3), as amended, "1986, 1987, and 1988" shall be replaced by "1986, 1987, 1988, and 1989."

(b) In paragraph b. of Decision No. 7600-(84/3), as amended, "1988" shall be replaced by "1989."

3. The review of the Policy on Enlarged Access and access limits thereunder in the light of the outcome of the Ninth General Review of Quotas shall be completed not later than the effective date of any quota increase under such Review.

Decision No. 9028-(88/171), adopted
November 23, 1988

5. AUDIT COMMITTEE, FY 1989 - COMPOSITION AND NOMINATIONS

The Executive Board approves the Managing Director's recommendation that Burma, Belgium, and Saudi Arabia be invited to submit nominations of persons to serve on the External Audit Committee for financial year 1989 and confirms the nominations set forth in EBAP/88/277 (11/11/88).

Adopted November 22, 1988

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/282 (11/18/88) and EBAP/88/284 (11/21/88) and by an Assistant to Executive Director as set forth in EBAP/88/283 (11/18/88) is approved.

APPROVED: May 23, 1989

LEO VAN HOUTVEN
Secretary