INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/173

3:00 p.m., November 30, 1988

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
Dai Q.	Zhang Z.
	C. S. Warner
	D. C. Templeman, Temporary
	J. Prader
	L. B. Monyake
E. V. Feldman	R. J. Lombardo
	M. A. Fernández Ordóñez
	R. Marino, Temporary
	A. M. Othman
M. R. Ghasimi	O. Kabbaj
G. Grosche	
J. E. Ismael	E. Kiriwat
B. Jalan	L. E. N. Fernando
A. Kafka	
M. Massé	
	K. Yao, Temporary
	I. A. Al-Assaf
J. Ovi	
	G. Pineau, Temporary
	G. Serre, Temporary
G. A. Posthumus	G. P. J. Hogeweg
C. R. Rye	
	S. Yoshikuni
	N. Kyriazidis

C. Brachet, Acting Secretary
M. J. Primorac, Assistant

Also Present

R. Mariki, Minister Plenipotentiary, Embassy of Tanzania. IBRD: R. W. Grawe, Africa Regional Office. African Department: M. M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director; J. Artus, J. M. Jiménez, E. M. Taha. European Department: E. J. Zervoudakis. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; H. B. Junz, Deputy Director; P. D. Brenner, G. Fajgenbaum. Legal Department: R. H. Munzberg, Deputy General Counsel; J. K. Oh, J. V. Surr. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Berthet, S. J. Fennell, D. V. Pritchett, B. B. Zavoico. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; M. E. Bonangelino, L. A. Cardemil, H. P. G. Handy, J. E. Leimone. Special Advisor to the Managing Director: A. K. Sengupta. Advisors to Executive Directors: F. E. R. Alfiler, P. E. Archibong, A. G. A. Faria, M. Eran, S. M. Hassan, P. D. Péroz, P. Petérfalvy, M. Pétursson, S. P. Shrestha, M. A. Tareen, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, A. A. Badi, S. K. Fayyad, J. Gold, M. A. Hammoudi, A. Hashim, M. Hepp, J. Heywood, L. Hubloue, K.-H. Kleine, M. A. Kyhlberg, W. K. Parmena, L. M. Piantini, S. Rouai, Shao Z.

1. PERU, AND NIGERIA - REPORT BY STAFF

The staff representative from the Western Hemisphere Department, reporting on the staff's consultation discussions on Peru's overdue financial obligations, said that the mission to Peru had been well received by the economic authorities. The staff had had several meetings with the Minister of Economy, the President of the Central Reserve Bank, and other officials, and had also met briefly with the Prime Minister.

The situation in Peru was deteriorating rapidly, the staff representative indicated. There were widespread shortages, in particular of imported food. The rate of inflation had averaged 1,100 percent in the past 12 months, and if the inflation rate of the past four months was annualized, the inflation rate was currently 10,000 percent. At the same time, real GDP was contracting sharply, having declined by about 9 percent during the third quarter of 1988 on an annual basis.

The net foreign assets of the Central Reserve Bank had declined by close to $500 million in the first ten months of 1988, and the staff anticipated a further reserve loss on the order of $200 million or more in the following two or three months, the staff representative remarked. Liquid reserves were at a very low level. At the same time, labor troubles were mounting. Particularly critical was a strike in the mining industry that had begun in mid-October, affecting 50-60 percent of Peru's total exports. The losses from that strike alone, if it continued, would be $60-80 million a month, which would be in addition to the $200 million reserve loss already cited.

The mission had urged the authorities to adopt a comprehensive adjustment program, the staff representative continued. Five elements were concentrated upon: immediate measures to close the fiscal deficit; floating of the exchange rate; elimination of backward wage indexation; freeing of interest rates; and the elaboration of a strategy to bring Peru back into the international financial community. The staff had discussed various aspects of possible fiscal measures and had tried to work with the authorities in developing certain temporary tax measures that might be introduced in the early stages to permit a more gradual removal of the large-scale subsidies on basic foods, and to moderate the hardship imposed on the poorer segments of the population.

While the mission had been in Lima, a major debate had taken place on economic policy, with the Minister of Economy and the President of the Central Reserve Bank urging strong actions, the staff representative said. However, President Garcia and several of the cabinet members had been arguing for a more gradualist approach. In the circumstances, the staff had agreed with the authorities that the mission should return to Lima to complete the Article IV consultation when the debate was resolved and decisions had been taken. The staff had also explained to the authorities a possible way of dealing with arrears to the Fund through a shadow program. However, there was no indication that such a procedure would be viable at the current stage.

After the mission had returned to Washington, new measures had been announced along the lines of the gradualist approach, the staff representative from the Western Hemisphere Department reported. Those measures did not go far enough to close the fiscal gap, in his view. Following the adoption of a new package of measures, the Minister of Economy and the two Vice Ministers of Economy had resigned. It had been agreed with the President of the Central Reserve Bank that a mission would return to Peru in the week of December 11-16, at which time contact with the new economic team would be initiated and the staff would work toward completion of the consultation discussions.

Mr. Templeman said that his chair had been particularly interested in the prospects for a shadow program, which the staff representative from the Western Hemisphere Department had said were not promising. Was it possible that such prospects might improve at the time of the next mission? On the possibility of the Peruvian authorities making some payments to the Fund in the near term, the figures presented by the staff representative indicated a difficult situation; could he presume that no other creditors had received payments?

The staff representative from the Western Hemisphere Department said that he was not very optimistic with respect to the prospects for a shadow program. However, one of the reasons for the mission returning to Peru was to maintain contact with the authorities and open a dialogue with the new ministers. On the cash flow, the liquidity position of the Central Reserve Bank was very strained, with very few payments of principal or interest having been made. Some payments had been made to the U.S. Government for certain programs. Peru was close to the maximum limit of 180 days arrears to the Inter-American Development Bank--after which it would be put in nonaccrual status--and it might currently be over that limit. Arrears to the World Bank were close to $400 million.

Mr. Templeman asked whether the measures recently taken had been in the context of a six-month plan.

The staff representative from the Western Hemisphere Department said that, as he saw it, the measures recently undertaken would be followed by rounds of price, wage, and exchange rate actions at increasingly frequent opportunities. There was no mechanism for maintaining public sector prices in real terms. With the passage of time and as exchange rates moved, the fiscal gap would tend to re-emerge, requiring frequent new rounds of measures.

The Acting Chairman reported that the Managing Director had reached final understandings with an official Nigerian delegation on a program that could be supported by the Fund with a 15-month stand-by arrangement. The staff would be issuing the necessary documentation in the near future, and it was hoped that the Board discussion could be held before the end of January 1989. The major problem still confronting Nigeria was to obtain the necessary financing to close the external gap.

The staff representative from the African Department added that Nigeria's economic circumstances had been very poor in the past few years. Oil export earnings had fallen from over $25 billion in 1982 to an estimated $7.2 billion in 1988. At the same time, the country's debt service burden had increased substantially, while the Government's policies to carry out domestic adjustment had lagged considerably.

Negotiations on a program with the authorities had been continuing since July 1988, but they had been affected by the rather unstable international environment resulting from declining and fluctuating oil prices, the staff representative said. Moreover, in the end of 1987 and the first half of 1988, Nigeria had suffered mounting financial domestic imbalances, which the program discussed with the authorities sought to reduce. Actual implementation had begun in parallel with the discussions, leading to substantial progress being recorded in 1988. The staff was currently projecting that the Federal Government's cash deficit would emerge at about 12 percent of GDP by the end 1988, compared with the budget level of about 16 percent. In line with that improvement, domestic financing would fall to below 8 percent, from an estimated level of nearly 14 percent. Those improvements in the fiscal stance would allow the Government to tighten its credit policy and domestic credit, and broad money would expand considerably less than had been earlier projected. The program discussed for 1989 sought to build on that progress.

The fiscal program was targeting a federal government deficit of 8.4 percent of GDP, and a substantial reduction of the domestically financed component to about 1.3 percent of GDP, the staff representative continued. Those significant adjustments would lead to a marked tightening of the monetary policy stance. Net domestic credit was projected to grow by slightly over 9 percent in 1989, compared with an estimated 27 percent in 1988. Broad money expansion was projected at under 11 percent compared with 33 percent in 1988. Such policies would go a long way in protecting the Government's foreign exchange policy while helping to reduce inflation, which had reached very high levels in 1988.

Beginning the previous week, the Government had freed the exchange rate in the interbank market and had allowed the exchange rate in the auction market to rise also, the staff representative reported. By Friday of the previous week, the interbank market rate had reached ₦ 7.4 to the U.S. dollar compared with ₦ 6 to the U.S. dollar the week before, and the auction rate had reached ₦ 5.3 to the U.S. dollar, compared with ₦ 4.9. Under the program being negotiated, the authorities would be unifying those rates into a single rate managed by the interbank market. The domestic policies envisaged would help in the adjustment of the external sector by limiting import inflows and encouraging exports and other foreign exchange earnings.

On the external side, the staff had faced the need to establish a central scenario for the balance of payments, with accompanying adjustments for changes in oil prices, the staff representative continued. Under the central scenario, the staff had assumed that oil prices for

Nigeria would average about $14.50 per barrel and that Nigeria would maintain its OPEC quota. With a need to maintain a minimum level of imports, the balance of payments was currently projected to show a financing gap of about $9.4 billion. Of that, about $5.5 billion arose from arrears that had been built up on debt service in 1987 and 1988. Directors were already aware that the Nigerian authorities were in the process of concluding an arrangement with the London Club, which was expected to be signed in January. While that did not provide additional new money for Nigeria, it did provide much relief from current maturities and provided Nigeria with a package that would stretch out the payments of consolidated debt to the banks over a period of 20 years. The package had also reduced the margin over the London interbank offered rate from previous agreements. It was expected that it would provide a total debt relief to Nigeria in 1989 of about $2.9 billion.

Preliminary discussions had begun with Paris Club creditors with regard to a possible Paris Club rescheduling, the staff representative indicated. In their presentation to the Paris Club, the authorities had requested that all maturities due in 1989, as well as arrears to Paris Club creditors from previous years--including previously rescheduled arrangements--be rescheduled in 1989 with a consolidation period that would cover January 1, 1988 to December 31, 1989. Under that scenario, it was foreseen that the Paris Club could grant Nigeria debt relief of about $4.5 billion, under the assumption that other bilateral creditors would provide similar assistance. It was projected that total debt relief for 1989 could total $8.3 billion. The staff foresaw that the remaining $1.1 billion of additional financing needed to close the gap would emerge from the program loan negotiated with the World Bank and additional bilateral assistance. It was the staff's understanding that that loan would be presented to the Bank Board in the next few days, and it was expected to attract cofinancing from Japan. The authorities had informed the staff that the U.K. authorities had indicated their willingness to provide $100 million and to seek best efforts from other creditors for the remaining amount. On the basis of such an effort, the staff foresaw that the financing gap could be closed. Of course, the financing gap data depended on the assumptions made on the petroleum price. The staff faced the danger that oil prices might turn out to be more pessimistic than the prices assumed in the program. The primary contingency foreseen for that event might be actual use of Fund resources, since the authorities did not intend to actually draw on the resources made available by the stand-by arrangement. In addition, the program had a built-in mechanism in the budget to reduce expenditure, if oil prices turned out to be lower than foreseen.

2. ESAF TRUST - BANK OF GREECE - ESTABLISHMENT OF ADMINISTERED ACCOUNT

The Executive Directors considered a staff paper on the establishment of an administered account for a subsidy contribution to the ESAF Trust by the Bank of Greece (EBS/88/240, 11/23/88).

Mr. Monyake expressed his chair's appreciation for the contribution by Greece to the subsidy account of the ESAF Trust. His authorities were among those that benefited from such arrangements, and he supported the proposed decision.

The Executive Directors then took the following decision:

1. Pursuant to Article V, Section 2(b), at the request of the Bank of Greece (the "Bank") as set forth in its letter dated November 18, 1988 (Annex II to EBS/88/240, 11/23/88), the Fund adopts the Instrument to establish an account for the administration by the Fund of the deposit to be provided by the Bank on the terms and conditions set forth in the Instrument contained in Annex I to EBS/88/240.

2. The provisions of the Instrument may be amended only by a decision of the Fund and with the concurrence of the Bank.

3. Pursuant to Article V, Section 2(b), the Managing Director is authorized to accept the proposal by the Bank (Annex III to EBS/88/240) to make a deposit with the Administered Account in the equivalent of SDR 35 million. The deposit shall be administered in accordance with the provisions of the Instrument adopted under paragraph 1 of this decision. The agreement between the Fund and the Bank on the deposit shall enter into effect on the date the Fund accepts the proposal by the Bank for a deposit with an Administered Account.

Decision No. 9030-(88/173) ESAF, adopted
November 30, 1988

3. TANZANIA - 1988 ARTICLE IV CONSULTATION, AND STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT

The Executive Directors considered the staff report for the 1988 Article IV consultation with Tanzania and Tanzania's request for the second annual arrangement under the three-year structural adjustment arrangement approved October 30, 1987 (EBS/88/227, 11/9/88; and Cor. 1, 11/29/88). They also had before them a background paper on recent economic developments in Tanzania (SM/88/253, 11/17/88), and a policy framework paper for Tanzania (EBD/88/318, 11/8/88), together with a statement by the Managing Director.

The Managing Director's statement read as follows:

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 22, 1988 discussion in Committee of the Whole of a paper entitled "Tanzania: Policy Framework Paper, 1988/89-1990/91."

1. The Committee of the Whole discussed the policy framework paper for Tanzania, and commended the Government for its continuing commitment to structural adjustment. There was widespread recognition of the important and difficult steps the Government had taken since the program began, and the strong response in economic output despite the recognized infrastructural bottlenecks. Speakers noted in particular the Government's success in maintaining fiscal discipline, and expressed satisfaction with recent policy actions to correct distortions to monetary policy caused by excessive marketing board overdrafts, by scaling back the role of the maize marketing parastatal, and taking the costs of the Strategic Grain Reserve into the budget.

2. Progress on pricing reform was also noted, as was the need to ensure that producer prices and interest rates were adjusted promptly to reinforce the incentives for restructuring. In this context, Directors stressed that structural and institutional reforms in key sectors, particularly in transport and agriculture, would also need to be pursued vigorously if liberalized prices were to assume their proper function.

3. Executive Directors generally commended the Government's recent action on the exchange rate, but stressed the importance of further adjustment, both to compensate for the continuing inflation differential, and to ensure that the exchange rate was consistent with the Government's program of trade liberalization, which itself was crucial to improved efficiency in the economy. However, a Director demurred on the relative urgency of such action. Exchange rate action was also recognized as important to strengthen export incentives, thereby improving the disappointing performance of traditional exports and continuing the encouraging response of nontraditional exports. In this connection, the importance of moving quickly and decisively on the reform of agricultural marketing was stressed.

4. Directors noted Tanzania's large parastatal sector and the need to improve the performance of state enterprises and to develop a proper role for the private sector. Staff described the Government's policy to eliminate recurrent subsidies and give managers of parastatals greater autonomy, making them more accountable for their performance. Macroeconomic policy had already reduced the level of economic protection to parastatals, and a process of restructuring, favoring the more efficient enterprises, had begun. While the desirability of a strong complementary private sector response was recognized, the tentativeness of some segments of the private sector itself, and

the evolving commitment of government to a new private sector approach, dictated a measured pace. The formation of a new Investment Code was welcomed, as was the raising of interest rates to marshal private resources through savings.

5. The social aspects of the adjustment process received considerable attention and Directors expressed concern about the potential negative impact of the adjustment process on vulnerable population groups. Staff pointed out that the general impact of the recovery program had been strongly positive. The Government of Tanzania had long recognized the importance of basic social services and was developing a monitoring system, sensitive to the potential for hardship.

6. Directors noted the importance of special and concessional resource flows to the continuation of necessary policy reforms. In this context, exceptional debt relief would be a crucial element in maintaining balance of payments viability.

7. Finally, Directors inquired about government policies in relation to longer-term development issues, such as population and the environment, noting that those too required systematic inclusion in the overall development strategy and that both were intimately related to the economic progress that the Government's program was designed to promote.

Mr. Mariki, Minister Plenipotentiary of the Embassy of Tanzania, was present.

Mr. Monyake made the following statement:

On behalf of the Tanzanian authorities I wish to thank Fund management and staff for their constructive effort in the recent negotiations culminating in the proposed second annual arrangement under the structural adjustment facility. The authorities' policy measures during the first year of the arrangement under the structural adjustment facility (1987/88) met with commendable success in further accelerating the pace of GDP growth rate to 4 percent as targeted. However, slippages occurred in program implementation largely owing to bottlenecks on the supply side in the face of successive bumper crops of maize and cotton. Thus, not only was the processing, transportation, and marketing system overloaded with agricultural produce but the larger stocks and longer credit cycles of marketing boards and cooperative unions led to considerable expansion in domestic credit. The primary focus of the 1988/89 program is, therefore, to eliminate the structural bottlenecks, and provide further stimulus while reinforcing macroeconomic management policies to attain the initial policy framework paper objectives. Those objectives include the reduction of the rate of inflation to

18 percent by the end of the program (1988/89) from the present 30 percent and steady improvement in the external balance of payments.

Under the 1988/89 program, the Government has already put in place a number of carefully considered policy measures to eliminate the structural bottlenecks in agricultural marketing, transportation, and industrial fields. Last year, Tanzania realized a surplus in domestic production of maize but not in the other major food crops. However, owing to a number of factors, including the unusually large size of the annual maize crop, the National Milling Corporation (NMC) encountered difficulties in handling maize, resulting in heavy losses estimated at T Sh 4.7 billion. Following grain marketing studies in collaboration with external consultants, the authorities have now introduced a more flexible marketing system, which enhances the autonomy of cooperative unions, primary societies, and private traders in the marketing of foodstuffs. The authorities have not found it appropriate, given the situation in Tanzania, to abandon the panterritorial marketing policy because that would discourage maize production in the remote maize producing areas and jeopardize the national goal of food security. However, the role of the NMC has been sharply curtailed so that it will henceforth operate only as a commercial agency, purchasing and selling produce for profit. The role of holding strategic food stock will now be played by the Strategic Grain Reserve (SGR), which is an independent buffer stock. Initially, however, the NMC will manage the SGR as a government agent in 1988/89 and will be reimbursed the direct costs of holding, storing, and transporting the SGR maize. The SGR could realize a surplus or a deficit depending on the food supply situation and the government policy on pricing; such a deficit will be covered from the budget.

The authorities will continue to pursue producer prices that will stimulate export crops. They have stated that except for cotton and tobacco, which are faced with transport and processing difficulties, all export crops were granted real producer price increases in excess of 5 percent in 1987/88. Assuming a consumer price index of 18 percent in 1988/89, the producer prices of export crops announced for 1988/89 are positive in real terms with rates of increase varying from 2-7 percent for tobacco, 15 percent for cashew nuts, 17 percent for tea and pyrethrum to 18 percent for coffee. The cotton price has again been raised by a nominal 15 percent but will be reviewed early in 1989 when the crop-specific action programs for cotton, tobacco, and coffee are activated. In the cotton sector, a severe constraint has been the ginning and transport capacity which led to the accumulation of stocks in the Tanzania Cotton Marketing Board (TCMB) and ultimately to a deficit of T Sh 2.1 billion. During the last year the Government has been expanding the capacity for ginning and transportation of cotton to the Indian Ocean. Ginning capacity has risen from 300,000 bales to close to 500,000.

Rehabilitation of the transportation sector will constitute the focus of public investment in 1988/89 and beyond. The magnitude of the rehabilitation work and the resources required is such that they have to be stretched over several years. Accordingly, the Government has already launched an emergency program for the Tanzania Railway Corporation (TRC), a long-term development program for the Tanzania Zambia Railway (TAZARA), a modernization program for the Dar es Salaam port, and rehabilitation programs for trunk roads and rural roads. The rehabilitation of the routes, the addition of rolling stock, and the modernization and expansion of port capacity that is under way are expected to enhance considerably the capacity of Tanzania to handle agricultural crops, and exports in particular, in 1988/89 and beyond.

The industrial sector made only a modest upturn, with capacity utilization rising to 25 percent during 1987/88 in response to greater access to foreign exchange. In collaboration with the World Bank under the Industrial Rehabilitation and Trade Adjustment Credit (IRTAC), the authorities have decided to undertake a comprehensive program of industrial restructuring over 1989-92. The program will start during 1988/89 with the formulation and implementation of action programs in sectors deemed to have the highest potential for efficiency and greater backward linkage. Three subsectors that have been identified under this program are textiles, leather, and agroprocessing. The action programs will cover the requirements in terms of technical and organizational measures to promote growth. In addition, the Government is eliminating most price controls and channeling external assistance toward rehabilitation of the subsector.

A good measure for capturing progress made in fiscal adjustment is the room created for bank credit for productive sectors through progressive reductions in government demand for bank financing. Against this yardstick, considerable adjustment was made during 1987/88 when deficit financing, estimated at T Sh 4.7 billion (including local counterpart of first year disbursement of T Sh 2.1 billion, treated as bank credit to the Government) represented only 14 percent of domestic credit expansion. This achievement was realized through considerable restraint in government expenditure even as external financing fell short of target. Although revenue performance also fell short of program target, the ratio of revenue to GDP rose by 1.9 percentage points of GDP. The authorities expect to raise the ratio of revenue to GDP further from 18.0 percent in 1987/88 to 21.5 percent in 1988/89 leading to a deficit level (10.4 percent of GDP on a checks-issued basis) that could be financed without recourse to the banking system.

Structural improvements on the revenue side that will substantially increase tax yields include the reforms in the external sector, notably the expansion of the open general license (OGL) system; the customs tariff reform; and the ongoing exchange rate depreciation. As far as income tax is concerned, the Government has mounted a massive program of strengthening the administrative machinery through more and better trained employees and increased equipment. At the same time, income tax rates have been streamlined and simplified. The Government has also increased some sales taxes, fees, and charges.

On the expenditure side, the 1988/89 budget concentrates on rehabilitation and the development projects that are already under way, avoiding the initiation of new ones. In the meantime, the Government has continued the freeze on the size of the civil service except in education, health, and revenue-generating services, but will allow a 25 percent nominal increase in the wage bill to accommodate a 10-20 percent increase in salaries. In order to exercise tighter control and monitoring of the budget process, a budget management program has been launched. This program is designed to improve budget guidelines and reporting procedures so that at any time in the course of the year the Government will have an idea of the expenditure level. For example, the Customs Department will continuously monitor the value of imports that go to externally funded projects.

The excess liquidity during the first year under the structural adjustment facility was largely the result of unanticipated large stock financing and marketing board overdrafts. The reform and rehabilitation measures in the production and marketing areas should eliminate a considerable proportion of this demand for bank credit. For the rest of the program, therefore, bank credit will be utilized predominantly in line with government priorities for productive enterprises. In order to stimulate savings and resource mobilization, the Government is now carrying out a study of financial institutions with a view to diversifying their functions, enhancing competition, and promoting efficiency. Although the Government has pursued a policy of upward adjustment of interest rates in order to achieve positive real rates of interest reaching 80 percent of the rate of inflation in July 1987, interest rates did not reach positive real levels last year. However, through further increases in nominal rates planned for December against abating inflation, the authorities will achieve substantially positive deposit and lending rates early in 1989.

The authorities made considerable progress in the external sector in 1987/88, but did not attain the first year structural adjustment facility objectives because of the infrastructural problems discussed earlier, a sharp deterioration in the terms of trade, a shortfall in capital inflows, and related inability to proceed with a high pace of exchange rate depreciation. The authorities have restated their commitment to pursue a flexible exchange rate policy until they attain an appropriate rate. However, they have ruled out the use of the "black market" rate as a proxy for an appropriate rate and are now working on the approximation of a proxy based on their foreign exchange import schemes. They consider these schemes to be preferable because they operate in a market that is liberalized, legalized, and open, representing about 25 percent of total imports. They also consider that the target for open general license (OGL) should be pursued pragmatically and in close coordination with exchange rate export growth performance during 1988/89. The authorities have underscored the importance of this policy and the need to proceed with caution since the economy is operating well below capacity with earmarked priorities for economic recovery that are likely to persist in the medium term.

Against this background, the Tanzanian shilling was depreciated from T Sh 63.5 to the U.S. dollar at the beginning of 1987/88 (July 1987) to T Sh 97 to the U.S. dollar by end-June 1988. Under the current program the authorities expect to make considerable progress in bringing the exchange rate closer to an appropriate level. This process has been accelerated, through a combination of the continuous depreciation of the real effective exchange rate following the recently announced depreciation to T Sh 120 to the U.S. dollar in November on the one hand and the simultaneous progress being made toward lowering the rate of inflation to 18 percent by end-June 1989. The adequacy of the exchange rate policy will be assessed in the light of progress in increasing foreign reserves and eliminating external arrears, and the volume of exports.

Tanzania's debt profile will not permit the restoration of viability in the medium term without debt rescheduling on the most concessional terms combined with debt cancellation. At present, scheduled external debt service for 1987/88 stands at 68 percent. Accordingly, the Government has called for a Paris Club rescheduling for next month and plans to seek rescheduling with non-Paris Club creditors soon thereafter. In the medium term, the Government recognizes the need to pursue a very cautious external borrowing policy as nonreschedulable debt service to multilateral agencies will remain heavy. Thus, considerable financing in grant form will be required for some years to complement Tanzania's own savings.

It is important to stress to Directors the commitment of the authorities to growth-oriented adjustment. They have pursued their program very pragmatically. Indeed, when the social burden of adjustment became unbearable, the authorities allowed a temporary tactical relaxation in the pace of adjustment during the period January-June 1988. At that time it had become certain that the adjustment strain from the budget, interest rates, and the exchange rate could not be sustained by the urban population; the rural population of small but modernizing farmers applying modern methods and imported inputs; and cooperative unions, which were running into heavy losses. The authorities were left with no option but to slow the pace of adjustment somewhat. More timely external inflows in line with program target could have sustained the pace of adjustment. Nevertheless, the authorities took the time to mobilize the necessary consensus so as to embark on another program for 1988/89 and intend to persevere until they attain external viability in the mid-1990s. They are grateful to the international community for the financial assistance they have received for their Economic Recovery Program, which they designed and launched in 1986.

Mr. Enoch made the following statement:

I am particularly pleased to have the opportunity today to discuss Tanzania's second annual arrangement under the structural adjustment facility. Tanzania is one of the Fund's very poorest members and for many years pursued an economic strategy based on centralized economic controls. The reform process upon which the authorities embarked, with considerable courage, in 1986 was therefore bound to be difficult and lengthy. The counterpart, however, has been the prospect of achieving a radical transformation of the economy.

There has indeed been considerable progress in implementing reforms since the Economic Recovery Program started in mid-1986. Major achievements include the sharp improvement in fiscal control, the considerable reduction in exchange rate overvaluation, and substantial price and trade liberalization. The impact of these reforms is already noticeable, for instance, in the acceleration in the growth of GDP.

That being said, Tanzania's performance under its stand-by arrangement and its first annual arrangement under the structural adjustment facility cannot be said to have been good. The stand-by arrangement performance targets were missed throughout 1987, and practically all the structural adjustment facility benchmarks for 1987/88 were also not achieved. Perhaps most noticeable amongst these was the money supply target, which was missed by a very substantial margin. This outcome relates very closely to the nonimplementation of the reform of the marketing boards during 1987/88, and the consequential unanticipated increase in credit to them. And it illustrates that when undertaking as ambitious a reform process as this, with all the problems of coordination that are involved, the authorities have to pursue all elements of the process vigorously; failure to pursue even a few component elements may jeopardize the hard-won gains achieved elsewhere.

The need now is to restore the momentum of the reform process, and with this in mind I welcome Tanzania's proposed second annual arrangement under the structural adjustment facility. I was particularly pleased by the recent sharp devaluation of the shilling, and the authorities' commitment to continue exchange rate adjustment through the first half of 1989. The establishment of a competitive exchange rate will be fundamental to implementing a comprehensive system of price incentives that encourages a more appropriate allocation of resources, both directly and by allowing further important exchange and trade liberalization and the enhancement of producer prices. I welcome the authorities' commitment to maintain positive real interest rates from the beginning of next year and to reform fully the National Milling Corporation and the other agricultural marketing boards. This last is perhaps the most fundamental, in the sense that action on this front will indicate an unambiguous change in economic strategy. The authorities' intention to remove transportation bottlenecks certainly seems appropriate. But these four elements are, as I said earlier, part of a package, and the authorities need to act vigorously on all four fronts. For instance, a reform of the marketing boards without an appropriate exchange rate might well not increase Tanzania's export revenues; indeed, there could be perverse results if unsold stockpiles resulted, and this could mistakenly bring the reform process, and the various elements within it, into disrepute.

While I support the thrust of the program before us, I do have a number of concerns. These relate to the authorities' seeming desire to keep the adjustment process gradual. While moving slowly might appear to be a commendably prudent strategy, and I can understand the concerns that underlie that approach, I think it has serious dangers. Adjustment fatigue may creep in if rapid results are not achieved, and it may become increasingly difficult to persist with the adjustment process. Moreover, firm action may well be necessary to give a clear signal to participants in the economy that the authorities are embarking on a radically different strategy, so as to induce the necessary radical change in behavior to bring about, for instance, a significant stimulus to private savings and investment. Thus, while I welcome the adjustments agreed on the exchange rate, I do note that they fall some way short of what was earlier thought, and indeed what the staff paper continues to suggest, as a competitive rate. The process of determining future exchange rate changes through the use of four diverse and potentially equivocal indicators runs the risk of further politicizing the exchange rate, with new delays interrupting the program again in the future. I consider it important to move rapidly to a system where a competitive exchange rate is institutionalized.

I also have some doubts over whether the programmed reform of the crop marketing system goes far enough. I fully endorse the staff's concerns about restrictions being maintained on pricing and trading, and on the dangers that might be posed by the operation of the Strategic Grain Reserve, notwithstanding the welcome decision to take the cost of the Strategic Grain Reserve into the budget. I am also concerned by the vagueness of the guidelines that will govern the activities of the marketing boards, given the clear demonstration of the weakness of their management.

The challenge facing the authorities is starkly illustrated by the size of the projected current account deficits and financing gaps. The financing gap is projected to remain more or less constant at almost half a billion dollars for each of the next five years ($455 million in 1993/94), and external viability can only be expected to be attained in the second half of the next decade. Clearly, Tanzania will require exceptional support from the international financial community.

Overall, therefore, I would conclude that the program before us represents the minimum that Tanzania needs to achieve. Any slippages to this program, even if not on the scale of those experienced over the past couple of years, could damage irretrievably the country's adjustment process and its prospects for sustainable long-term growth, especially since Tanzania needs to maintain the full support of creditors and donors. Indeed, the authorities may well wish to accelerate their reform measures. I recall that in the early months of its Economic Recovery Program, Tanzania undertook exchange rate adjustments ahead of schedule. Looking to the future, agreement on an arrangement under the enhanced structural adjustment facility will require a firm and thoroughgoing commitment to the reform process. I certainly hope that Tanzania will demonstrate this commitment, and will thereby gain early access to the enhanced structural adjustment facility, which it so clearly needs.

With these comments I can support the proposed decisions.

Mr. Posthumus made the following statement:

It is very satisfactory that the authorities and the staff have agreed on a number of outstanding issues, and that the authorities remain committed to the structural adjustment they have started earlier. It may be that the authorities feel constrained because creditors and donors often require agreement with the Fund as a condition for financing. However, it should be realized that the real constraint is the financial and economic situation facing the country.

The structural adjustment effort now under way clearly deserves the support of the Fund, as well as that of creditors and donors. Such support would be much more effective if financial and external adjustment--the traditional concerns of the Fund--were strongly pursued in the near future. The staff report shows that structural policies and fiscal policies were hampered by the limited financial and exchange rate adjustments in the course of 1988. Whatever the transportation problems are, a real appreciation of the exchange rate makes life for producers of tradable goods much more difficult. Thus, exchange rate policy continues to be very important. In fact, I wonder whether reaching a sustainable balance of payments position has sufficient priority in the program, when I read on page 21 of the staff report that will only be reached in the second half of the 1990s. I concur with Mr. Enoch's remarks on this issue.

I note with satisfaction that the staff has devoted substantial attention to the need to improve the tax system, and that there is no excessive pressure to decrease government expenditure. In Tanzania, social and distributional concerns weigh quite heavily in government policy, and that requires that some room remain available in the budget--financed by taxes--to finance social policies.

A remark on monetary policy: in view of the expected deceleration of the inflation rate, the staff "urges" the authorities on page 20 of its report to refrain as much as possible from long-term borrowing in this period of adjustment. Last year, money and liquidity increased rapidly due to the very high credit given to the marketing boards; I can therefore only agree with the staff if it meant that the Government should refrain from borrowing as much as possible to decrease the deficit. If, however, the staff is suggesting to borrow short rather than long, I would disagree strongly. Long-term borrowing is certainly less inflationary than short-term borrowing.

Finally, I have a question on Mr. Monyake's statement. He indicated that the social burden of adjustment became unbearable this year, in particular because of the budget, the interest rate, and the exchange rate. The authorities therefore had to slow down the pace of adjustment. I can understand that relatively cheap imports and negative real rates of interest are attractive for some groups of the population. However, what about producers of goods that compete with imports or that can be exported, and what about investments, even small-scale ones, being made on the assumption of negative real interest rates? I really wonder whether the "social burden" of adjustment is not in fact a burden for some, but not for others. At the same time, the slowing down of adjustment has its costs in the form of slowing down the positive effects as well, thus, for example, leading to a loss of exports. Was that loss considered when the political decision was taken to slow down adjustment?

Notwithstanding some questions, I support the proposed decisions.

Mr. Ismael made the following statement:

I am in broad agreement with the staff appraisal of the Tanzanian economy. While I recognize the difficulties that are unavoidably involved in any large turnaround of policy orientation, I am nevertheless disappointed to note that Tanzania has encountered serious difficulties in the implementation of the financial program for 1987/88, and that the external and internal imbalances have consequently widened further. Despite this setback, I agree with the staff that the 1988/89 program warrants continued support from the Fund; however, it must be implemented more rigorously and with greater determination.

To comment on a few specific areas, first, I note that the sharp increase in agricultural production in 1987/88 was not translated into a higher export volume owing to processing and transportation problems. This, together with the authorities' failure to implement the restructuring of the domestic marketing system, has adversely affected the operations and the financial situation of the marketing boards. It is, therefore, not surprising that the marketing boards' credit with the banking system has risen sharply, leading to nonobservance of almost all of the structural adjustment arrangement benchmarks. In this regard, I believe that the large credit to the marketing boards has constrained somewhat the performance of the private sector, whose credit needs have increased with the introduction of the open general license system for certain imports and the depreciation of the exchange rate. Therefore, I welcome the measures incorporated in the program for 1988/89-1990/91 to eradicate the structural problems in processing, transportation, and domestic marketing of the agricultural crops.

Second, I commend the authorities for adjusting the exchange rate of the Tanzania shilling in 1987/88, leading to a favorable response in economic output. The recent adjustment in early November and the plan to effect a further gradual depreciation of the real effective exchange rate during the rest of the program period are most welcome. However, a further adjustment of the exchange rate is needed if a competitive rate is to be established to boost the weak traditional export sector, as well as to further stimulate the improved performance of the nontraditional sector. Therefore, close monitoring will be required so that the authorities can respond promptly to any future unfavorable external developments.

Third, on the fiscal front, I am pleased to note the introduction of the first phase of the reform of customs tariffs and sales taxes, which has been agreed upon with the World Bank in the context of the Industrial Rehabilitation and Trade Adjustment Credit (IRTAC) program. I also welcome the reform of income taxation. In addition, the authorities should be commended for the measures introduced in the 1988/89 budget to strengthen the tax administration, although the impact of those measures will only be felt in the medium term. I note that the staff has recently undertaken a comprehensive review of the tax system, and I am confident that this review will assist the authorities in their tax reform efforts.

Fourth, in the area of monetary policy, I welcome the authorities' policy of gearing credit toward the productive sector and the containment of credit to the marketing boards. This will help the private sector to play a bigger role in the adjustment and growth process. I agree with the staff that close monitoring, together with follow-up measures and actions, are necessary to ensure that the marketing boards operate within their credit ceilings.

Fifth, I note that domestic savings have been erratic, and in fact declined in 1987, and that gross fixed investment has been financed by a substantial increase in current transfers from donor countries. This heavy dependence on foreign financing is unsustainable over the medium term and I would urge the authorities to maintain positive real interest rates so as to facilitate greater domestic savings mobilization.

In conclusion, I can go along with the proposed decisions.

Mr. Prader made the following statement:

I will focus my remarks on exchange rate policy and the reform of the marketing boards because actions in these two areas are bound to have a decisive effect on most other sectors of the economy.

While I welcome the authorities' recent decision to guide the exchange rate back onto a viable path after the slippage during the first half of 1988, I still have the distinct impression that more forceful exchange rate adjustments than now envisaged by the authorities may soon be needed to ensure the success of the 1989 program. Implementation of the planned liberalization of imports will provide a decisive test of the appropriateness of the present exchange rate level. Although I share the staff's view that the open general license system should fully reflect the excess demand for imports at any given exchange rate level, I wonder whether the liberalization of imports can proceed at the desired pace as long as the exchange rate system continues to produce sizable deviations between the official and parallel rates.

According to the staff report, the premium in the parallel market is presently in the range of 30-50 percent, far exceeding the standards considered tolerable in many other countries adopting Fund-supported programs. However, I would also suggest that the negative effects of such a premium on the allocation of scarce foreign exchange resources do not differ basically from those in other countries. Not only does the premium divert exports from the official channels, but it also seems to impede progress in any comprehensive import liberalization by encouraging imports at the official rate solely in order to profit by re-exporting them, at a considerable premium, through the parallel market.

Import liberalization can thus succeed only if it goes hand in hand with unification of the exchange rate at a competitive level. Although there seems to be no disagreement in principle on the requirement for unification, I wonder whether it can be accomplished in practice through the planned phasing out of the foreign exchange retention scheme unless the need for further major rate adjustments is accepted from the outset.

In his statement, Mr. Monyake explains that the authorities object to using the "black" or parallel market as a proxy for the appropriate rate, thereby ruling out devaluation of the shilling down to the level of the parallel rate. The authorities prefer to monitor exchange rate depreciation on the basis of demand developments in the open general license import scheme. While I have no major difficulty in principle with such an approach, I would also suggest that this scheme, which now reflects only 25 percent of total imports, can hardly be considered representative for letting the exchange rate find its appropriate level.

In my view, the open general license scheme needs to be liberalized rapidly in order to expose the exchange rate fully to the overall demand pressures in the economy and to promote a more efficient allocation of scarce foreign exchange reserves. I was therefore somewhat surprised to learn from Mr. Monyake that his authorities may finally decide to follow the opposite strategy, opening up the open general license system only gradually to avoid additional pressures on the exchange rate. Some additional explanations on the trade-off between rate adjustment and import liberalization, and on the staff's own preferences in this connection, would be most welcome.

The inefficiencies and financial pressures imposed by the functioning of the two marketing boards were painfully evident during the 1987-88 period, and I warmly welcome the planned reforms in this area. The reform of the export crop trading scheme seems generally appropriate, to the extent that it will be supported by the rehabilitation of the transport sector needed to avoid the recurrence of bottlenecks and by an exchange rate policy sufficiently active to guarantee a steady increase in real producer prices. The reform of the marketing and pricing of basic food commodities appears somewhat more problematic, since conflicting purposes seem to be involved. The goal of achieving greater economic efficiency must be reconciled with the Government's equally legitimate goal of achieving a high degree of food security. It is not quite clear to me whether the purpose of the recently established Strategic Grain Reserve is solely to avert food shortages during times of drought, or whether it will also serve to absorb the totality of excess production at a preset producer price. In the latter case, the new scheme seems exposed to the same kind of financial difficulties as the National Milling Corporation.

On the question of the panterritorial price system, perhaps Mr. Monyake could elaborate on his authorities' objections to the transition toward a more flexible pricing system. Do they feel that such a system, which would reflect transportation costs, would impose undue social costs on certain geographic areas and require offsetting measures to overcome the transition costs of greater efficiency? More generally, I understand that the authorities may be prepared to accept temporary relaxations in the pace of their reform program in order to cope with the social costs of the adjustment measures. While I find the authorities' preoccupation with the social implications of their adjustment program fully legitimate, I would suggest that when social concerns arise, they should be more openly and comprehensively discussed with the staff, so as to give the Fund a chance to explore and recommend alternatives or offsetting solutions that would not put the program itself at risk.

The task that the authorities have set themselves--of placing their economy on a path of greater internal efficiency and external viability--is enormous, because all aspects of their long-standing production and distribution systems require thorough redesign. After three years of adjustment, it is as clear as ever that an effort of such magnitude can succeed only in the medium term. Meanwhile, the authorities' commitment to fundamental reform deserves our full support.

Mr. Grosche made the following statement:

I am pleased to discuss today the second annual arrangement under the structural adjustment facility with Tanzania. The arrangement before us is embedded in a new medium-term economic program that envisages further steps on a very difficult road toward a better adjusted and more efficient economy. The arrangement appropriately focuses on the removal of structural impediments which so far have prevented recent reform measures from generating their full potential.

I can endorse the staff assessment of economic policies in Tanzania. I welcome in particular the proposed measures aimed at improving the marketing of basic food commodities. It appears that the implementation of these reforms will be critical to the attainment of the authorities' objectives. After all, as the staff report makes clear, the financial imbalances of the marketing boards for grains almost paralyzed the banking sector and thereby undermined the effective conduct of monetary policy, not to speak of the effects on inflation. Against this background, I am concerned that the measures now contemplated may not be sufficient to fully correct the situation. I certainly recognize that the authorities are faced with extremely difficult decisions, particularly in the areas of agricultural marketing and pricing. Nevertheless, I am convinced that the authorities would be well advised to explore all avenues for further reform in close cooperation with the World Bank and the Fund.

Regaining monetary control will be of the essence, as will be the revitalization of manufacturing and a larger role for private activity. In this regard, the authorities' intention to establish and secure positive real interest rates is quite appropriate in order to support savings and to provide the correct signals for a better allocation of scarce resources. Of equal importance is an appropriate exchange rate.

I welcome the partial correction of an overvalued exchange rate in early November and the authorities' commitment to further depreciations over the coming months. If the structural reform measures are implemented as planned, these steps should help to reduce somewhat the pressure on the external accounts. However, like previous speakers, I am concerned about the long time frame that is now contemplated for reaching balance of payments viability. From a domestic standpoint, an up-front depreciation would probably have been the preferred course of action. As it is now, monetary policy and also fiscal policy will have to be very tight in order to convey credibility to the overall stance of economic policies. If that is not the case, inflationary expectations could re-emerge, which in turn could adversely affect resource mobilization. But I must repeat that even the limited exchange rate adjustment is welcome, indeed, and of critical importance for the attainment of external viability.

In sum, I am satisfied that, if fully carried through, the arrangement before us will make an important contribution toward further improving the economic situation in Tanzania. The staff's medium-term scenarios indicate, however, that the authorities will continue to face severe financial constraints. It is therefore all the more important that they adhere to the agreed adjustment measures and closely monitor developments. Particular attention should be paid to external competitiveness in order to generate sufficient export earnings for the restructuring of the economy. I am confident that the authorities will not hesitate to take the required actions, and I am sure that such an approach will be honored by the international financial community.

I can support the proposed decisions.

Mr. Serre made the following statement:

This chair would like to express its support of the authorities' commitment to the Economic Recovery Program, despite a difficult internal environment. The present acceleration of economic growth presents an opportunity to reinforce adjustment measures in order to address structural imbalances and to restore financial discipline. Since we agree with the targets of the policy framework paper and with the staff report, we will only stress the major points aiming at reversing the current unfavorable trends, namely, structural problems, macroeconomic policies, and the external sector.

Concerning structural problems, we welcome the incorporation, through the second annual arrangement under the structural adjustment facility, of measures that address processing, transportation, and marketing constraints. In particular, we strongly believe in the liberalization of the marketing system and the limitation of government intervention in the management of the Strategic Grain Reserve. In such a context, existing cooperative structures and private initiative will be able to coexist, working toward further improvement of the whole economic system. In this regard, we urge the authorities to implement, as soon as possible, measures to remove transportation bottlenecks in order to reach export objectives. We also welcome the program supported by the World Bank to improve the policy and institutional environment for the public sector.

Turning to macroeconomic policies, we agree with the staff on the necessity to implement a tight budgetary policy consistent with GDP and monetary growth. We urge the authorities to monitor closely the reforms presently on track and to pay particular attention to the settlement of marketing board overdrafts. In the monetary policy area, much has to be done. It is clear that persistent weakness in management and financial monitoring might introduce further serious slippages. Attaining the benchmarks set for the 1988-89 program will be the real test of success for this program.

As regards the external sector, all the measures recommended by the staff must be implemented rapidly. There is no room for complacency in this area; a pragmatic exchange rate policy that will ease and facilitate adjustment in general is essential and will, of course, enable local competitiveness to increase.

To conclude, the program gives us a good idea of what still has to be achieved for Tanzania to reach more solid ground. The authorities have given us a clear signal of their determination to carry out this program as successfully as possible. We support the proposed decisions.

Mr. Marino made the following statement:

We see with great satisfaction that the authorities' perseverance with the adjustment effort and structural change has been rewarded with an acceleration in the rate of growth of GDP from the low levels prevailing during previous years. The task now faced by the authorities is to maintain the growth momentum of their economy. Unfortunately, structural bottlenecks stand in the way of the proposed objective. In this regard, we welcome the decision to focus the public investment program on the restoration of the transportation sector. An improvement in the conditions of the roads and ports is essential in promoting the nontraditional export sector, which plays an important role in Tanzania's Economic Recovery Program.

The difficulties encountered by Tanzania during the implementation of the financial program for 1987-88, such as larger than anticipated monetary expansion, the persistence of a high inflation rate, a weakening of the external position, and an important accumulation of external payments arrears merit careful evaluation and should serve as a lesson of experience for the new financial program under the structural adjustment facility.

Tanzania's objectives for the next three years include a growth rate of 4-5 percent per annum, a reduction of inflation, and a major improvement in the external position. We hope that all of these objectives will be met, but we note with concern that the attainment of some of them might involve sacrificing some others. Particularly difficult to envisage is the meshing of the reduction in inflation with a further real exchange rate depreciation, an increase in interest rates, and the realignment of producer prices. If, on the other hand, growth or wages are used as the slack variable, the mounting social burden of adjustment might produce a relaxation of the adjustment effort, with important consequences over the medium term. Any comments by the staff on the impact of the exchange rate depreciation on prices in Tanzania would be welcome.

With respect to the external sector, the adjustment program contemplates a vigorous increase in export volume coupled with a very modest growth in import volume over the next three years, the elimination of payment arrears, and a strengthening of reserves. The success in restoring a self-sustained external sector in the medium term in Tanzania--as pointed out by Mr. Monyake and in the policy framework paper--depends on a temporary boost in external support over the medium term, in the form of both official transfers and other bilateral and multilateral disbursements, including debt rescheduling and debt cancellation. We consider this to be the crux of the whole economic package and thus urge the international financial community to reach a prompt agreement on Tanzania's debt rescheduling.

We would like to join previous speakers in commending the authorities for their efforts in implementing the structural changes required in their economy, and we endorse the proposed decisions.

Mr. Massé made the following statement:

We welcome the conclusion of the extended discussion between the Tanzanian authorities and the Fund, as well as the agreement on a program. We regret the difficulties in the implementation of the 1987/88 financial program and hope that obstacles facing the authorities have now been resolved, thus permitting the full implementation of this program.

Despite serious slippages in the past year, significant reforms have been implemented since 1985. As described in the staff report, these include substantial adjustment to the exchange rate, liberalization of prices and imports, better expenditure management, and reform of the tax system. The benefits of these reforms are now becoming evident, and as noted in Mr. Monyake's statement, are in part responsible for the strong economic growth in the past year. Nevertheless, much remains to be done, and the medium-term outlook continues to be extremely uncertain. Overall, my authorities concur with the staff report and support the program. I would, however, like to highlight a number of concerns that we think are essential to the success of the program this year and in the medium term.

In the case of Tanzania, it is evident that structural reforms are of paramount importance and just as crucial to the success of the adjustment process as appropriate macroeconomic policies. Of major importance is reform to pricing and marketing of agricultural goods both for domestic use and for exports. As in the previous year, the program has run into serious problems in the area of credit to the agricultural sector. This will only be resolved by a comprehensive restructuring of agricultural pricing and marketing policies. I note that steps to that end have already been taken and the program contains additional reforms. However, we remain concerned that the authorities underestimate the misallocative impact of a rigid producer pricing policy and may overlook the medium-term importance of a more flexible price and marketing strategy.

Such reforms are also crucial for the continuous expansion of the export sector. The medium-term prospects for Tanzania remain difficult, and the only viable strategy is continued growth and diversification of exports. While the major constraint to expansion of the volume of exports in 1987-88 was severe supply bottlenecks, including problems of transportation, proper price incentives are key in the medium term. My authorities remain concerned that the bottlenecks cannot be eliminated as quickly as anticipated in the program and, consequently, the targets for growth of exports and reserves are likely to be overly optimistic.

Just as important to the adjustment process is continued exchange rate adjustment. We note that there has been a significant devaluation at the beginning of this month, and that the program provides for additional minor devaluations in real terms in the period ahead. Nevertheless, it appears that a large gap between the official and parallel market rates will continue to persist. We urge the authorities to adopt as ambitious an exchange rate policy as possible. From Mr. Monyake's statement, it is clear that this is subject to much political debate in Tanzania. However, in light of the importance of such adjustment to improvements of the medium-term prospects, there would appear to be no real alternative. The authorities should consider that, as is often the case, large and infrequent devaluations are likely to be easier to implement than more gradual but repetitive rounds of exchange rate adjustments.

We commend the authorities for their success in constraining total government expenditures and their continued efforts to reform the tax system. We also welcome the intention of the authorities to establish a positive real interest rate by the end of 1988. We note that the authorities intend to reform the financial sectors to improve financial resource mobilization. In light of the fact that one bank--the National Bank of Commerce--completely dominates the banking sector, I would be interested in some information from Mr. Monyake or the staff on whether these reforms provide for any restructuring of the financial sector to increase competitiveness.

Finally, my authorities would like to see Tanzania benefit from enhanced structural adjustment facility resources. For this to occur, it is crucial that Tanzania implement a strong and comprehensive program in a sustained fashion. In this regard, we would urge the authorities not to waiver in their commitment to this program and to undertake when possible reforms above and beyond those specified in the policy framework paper.

We congratulate the authorities on the reforms they have so far successfully implemented and we want to assure them of our continued support in their present and future efforts.

Mr. Ovi made the following statement:

I am in general agreement with the staff's assessment of economic developments during 1987/88. The efforts to reach more market-oriented solutions have brought about improvements in many areas, and the authorities should be commended for having implemented a series of such measures even though these have been unpopular in the short run. Nevertheless, as shown by the staff analysis, the economy continues to be far from a situation characterized by sustained viability, and the staff's medium-term scenarios indicate that even under what seem to be fairly optimistic assumptions, no significant improvement is likely in the next few years.

During the last year, there have been substantial problems in the implementation of agreed adjustment measures in a number of areas. Despite favorable developments in the agricultural sector, which have brought about a considerable increase in GDP growth, implementation problems have contributed to a worsening of the balance of payments and increased arrears on the external debt. One of the reasons for these developments was the absence of further exchange rate adjustments in the course of the first nine months of 1988, as a result of which the real effective exchange rate appreciated markedly. In addition, the continued significantly negative real interest rates--a result of, inter alia, the insufficient restructuring of the financial system--have also been an important cause.

The difficulties experienced with respect to the process of transforming increased production into higher export volume indicate that--apart from a more realistic exchange rate policy--there is a need to strengthen supply-side conditions, inter alia, through investments in infrastructure and storage capacity. Furthermore, more market-related producer prices should increase the incentives for export-oriented production. Finally, the fiscal deficit has to be kept under strict control in order not to hamper structural adjustment.

Thus, even though many achievements can be noted, there is no room for complacency. In light of this, the understanding between Tanzania and the Fund on a second annual arrangement under the structural adjustment facility is most welcome. The significant exchange rate adjustment recently implemented is, in our view, both a positive and a necessary element. I agree, however, with the staff that there is a need for some further real depreciation. In general, we want to underline Mr. Monyake's declaration that the authorities will assess the adequacy of the exchange rate policy in light of progress in increasing foreign reserves, elimination of external arrears, and the volume of exports.

With regard to the revised program for economic and structural policies under the second annual arrangement, I agree with the staff's remarks on desirable supplementary action. However, provided that the present program is fully implemented, the result would be a clear strengthening of the ongoing adjustment process. Consequently, I fully support the continuation of the structural adjustment facility arrangement.

In sum, in light of the country's difficult situation, it is vital that the agreed reorientation of economic policy be achieved. This would also constitute a necessary background for a future arrangement under the enhanced structural adjustment facility. In view of the important structural reforms that are to be implemented under the present program and that will be needed to facilitate the economic development in the period thereafter, we hope that the authorities will be able to start discussions on an enhanced structural adjustment arrangement during this, the second year under the structural adjustment arrangement.

The already substantial financing gap will, under present assumptions, have no tendency to diminish in the medium term, underlining the critical importance of a positive outcome to the coming negotiations on debt rescheduling. The results achieved so far, together with the policy commitments entered into, should provide a good basis for such discussions, but the significant adjustment efforts in the period immediately ahead would be facilitated if further support, also in the form of debt relief, were to be forthcoming. Such support would enable the Government to provide the poorest population segments with fundamental economic needs while continuing economic adjustment during the critical period ahead.

Mr. Fernando made the following statement:

We are in broad agreement with the staff appraisal. The present program is consistent with Tanzania's low use of Fund credit as well as its status as a structural adjustment facility-eligible country. We are therefore happy to support the authorities' request for the second annual arrangement under the structural adjustment facility.

It is very encouraging to note the response of the economy to the varied price incentives in Tanzania's economic adjustment program. The steps taken in the area of pricing are a major adjustment from earlier policies. It is, however, a measure of the complexity of the task facing the authorities that the early and substantial benefits of adjustment in the agricultural production area are as yet inadequately reflected in export performance. This is most clearly seen in the case of cotton and tobacco, where several constraints have been encountered in translating a production surplus into exports. However, the production of nontraditional goods was on target, and this was closely linked to increased availability of imported inputs and to the exchange rate adjustment. The authorities' intent to broaden and deepen incentives in this area and their demonstration of commitment, as evidenced by the further adjustment of the exchange rate, deserve to be fully supported so as to ease the financing and other constraints to growth.

In the light of developments under the previous stand-by arrangement and the first annual arrangement under the structural adjustment facility, the revised balance of payments scenario, though showing substantial financial gaps in successive years, is more realistic. We recognize that important segments of this financing gap, such as the need for a higher level of imports and the achievement of a higher level of external reserves, reflect the imperatives of sustaining growth-oriented adjustment. The gap in the later years of the medium-term scenario is inevitably exaggerated by future obligations arising from the current debt rescheduling exercise. We fully concur with the staff's call for a temporary boost in external support in view of the element's critical importance for the success of the adjustment strategy over the medium term. The role that debt rescheduling can play in easing the financial constraints to growth in the near term is self-evident and we urge creditors to consider immediate debt relief measures.

Turning to performance under the first annual arrangement under the structural adjustment facility, we note the paradox of the extent to which the financial program was undermined by an unusually heavy agricultural supply response. The Tanzanian situation has many parallels elsewhere. It is unfortunate that the specific features of the program, including the pricing policy on agricultural produce, could not adequately factor in the capacity constraints of the private sector in absorbing supplies, as well as the operational cost of intervention by the state marketing agency. We commend the steps taken by the authorities to restructure the marketing agency and, in particular, the separation of the buffer stock function to reflect in a transparent manner the cost of providing food security.

A second issue concerns budgetary management and control. We noted how a speeding up of check cashing strained the Government's liquidity position, leading to greater recourse by the Government to the banking system to meet the shortfall. To the extent that this was a one-time development, this need not be regarded as adverse; given the aggressive environment for funds, such a development may be expected. What is important for the program's implementation as well as its monitoring is that the mechanisms in place are adequate and reliable enough to ensure that the amount of checks issued and the Government's incurring of liabilities are in line with the programmed level of budgetary expenditures. Both the authorities and the Board should be able to track on a timely basis whether adjustment is on an appropriate and sustainable path. Mr. Monyake's assurance in this regard is welcome and any additional staff comment on the budgetary management program would be useful.

Finally, we welcome Mr. Monyake's reiteration of the commitment of his authorities to growth-oriented adjustment. The balance of payments viability projected to be reached at the earliest in the mid-1990s is dependent on sustained and timely donor support.

Mr. Al-Assaf made the following statement:

I will begin by stating my support for the proposed decisions and commending the authorities for their commitment to the adjustment process. I agree with Mr. Monyake and other speakers that Tanzania has made commendable efforts in finding a solution to its economic difficulties. The revised program presented by the authorities acknowledges that the road ahead will not be an easy one, and I share their assessment of the main priorities for the period of the program. I shall therefore concentrate my comments on a few points.

First, there is the need to increase domestic savings. The successive declines in savings since the early 1980s have now led to a negative rate of savings estimated at 7 percent of GDP, a trend that should be reversed. A gradual return to a better balance of government revenues and expenditures would reduce or eliminate an important source of dissaving.

My second point, which is somewhat related to the first, is on the importance of keeping inflationary pressures in check. This is particularly important in order to realize a positive rate of return on savings and financial assets. The adjustment in deposit and lending rates, planned for December 1, 1988, will correct some of the present misalignment. However, strict implementation of the credit policy will ensure positive real returns over the longer term. In this context, the planned improvements in the system of marketing food crops should help in reducing the demand for bank credit and in avoiding a repetition of the negative influence of previous arrangements on the credit system.

Turning to the structural aspects of the program, the first essential area relates to agricultural marketing and pricing. It is encouraging to note that the revised program is giving due emphasis to this issue, as seen in paragraphs 41-51 of the policy framework paper. The reforms aimed at reducing marketing costs of export crops and improving the efficiency of the marketing system in general are particularly important. Their long-term consequences on the strengthening of the balance of payments makes the pursuit of these reforms worthwhile. Second, the structural weakness of the tax system, which has become more clear in the context of the 1987/88 budget, is in need of improvement. Progress along the lines of the 1988/89 budget is essential, and it is hoped that no slippages will occur. Finally, the reform of the financial sector should receive the priority it deserves so as to make a meaningful contribution to a much needed improvement in saving rates and resource allocation.

I would like to reiterate my support for the proposed decisions and wish the authorities success. I also join some of the other speakers in hoping that the authorities' adjustment efforts can soon be further reinforced by the conclusion of an arrangement under the enhanced structural adjustment facility.

Mr. Tareen noted that, following the rapid economic deterioration in the 1970s and early 1980s, the authorities had been implementing wide-ranging adjustment policies, supported by the Fund's structural adjustment facility. The objectives of the adjustment program have been to achieve sustainable economic growth, to reduce inflation, and to reduce both domestic and external imbalances. Although the results of that effort to date were somewhat mixed, the authorities, nevertheless, were to be commended for their continuing commitment to macro and structural adjustment. As a result of their policy measures, the authorities had succeeded in achieving the economic growth target of 4 percent in 1987/88, despite infrastructural bottlenecks.

Since he was in broad agreement with the staff appraisal, he would limit his intervention to a few comments on the second-year arrangement under the structural adjustment facility, Mr. Tareen remarked. On the fiscal side, he noted that the program for 1988/89 called for a major tax reform to enhance revenue performance on the one hand, and expenditure rationalization on the other. In that respect, he welcomed the increase in the ratio of revenue to GDP from 18 percent in 1987/88 to 21.5 percent in 1988/89, leading to an overall deficit of 10.4 percent of GDP on a checks-issued basis.

The program provided for a substantial reduction in the rate of inflation from 30 percent in 1987/88 to a projected 18 percent in 1988/89, Mr. Tareen went on. Considering that year-end inflation over the past four years had averaged more than 30 percent annually, and given the fact that the 1988/89 program allowed for a 25 percent increase in the wage bill, he wondered whether such a low inflation target was attainable. Staff comment on that issue would be appreciated.

With regard to exchange rate policy, Mr. Tareen recalled that the staff report indicated that the real effective exchange rate had not been at an equilibrium level in 1988, as had been envisaged in both the last stand-by arrangement and the first-year arrangement under the structural adjustment facility. However, he welcomed the authorities' actions on the exchange rate front to date, and in particular, their commitment to effect a further small depreciation through monthly adjustments during the rest of the program period.

Finally, the economic and financial program for 1988/89 represented considerable reinforcement of the adjustment policies begun in 1987/88, Mr. Tareen observed. He was confident that a timely and vigorous implementation of such policies would contribute importantly toward Tanzania's external and internal viability. However, concessional external assistance was an important element in the successful completion of the program. He could support the proposed decision.

Mr. Ghasimi made the following statement:

> At the outset, we would like to support the proposals made by the staff in connection with the Article IV consultation with

Tanzania as well as the request for a second annual arrangement under the structural adjustment facility. As we are in general agreement with the staff appraisal, we shall make few comments.

We welcome the recent economic developments in Tanzania, in particular the acceleration of economic growth, the recovery of the manufacturing sector, the promotion of exports, as well as the recent adjustment of the exchange rate. We are also pleased to note the realization, for the first time in many years, of a surplus in grain production. These achievements were made possible mainly by the structural reforms implemented within the framework of the Economic Recovery Program, supported by a three-year structural adjustment arrangement. We are impressed by certain achievements that have taken place under the program, in particular, the liberalization of marketing and pricing policies and the maintenance of fiscal discipline by containing expenditures and augmenting revenues.

It is disappointing that the authorities were unable to cope adequately with some of the prevailing problems because of slippages that occurred in the agricultural pricing policy as well as shortfalls in the performance of monetary and credit policies. However, it is encouraging to note from Mr. Monyake's statement that the authorities are cognizant of their problems and firmly intend to pursue liberalization of production, marketing, and pricing policies. Fiscal policy will be strengthened through improvements in tax administration and better containment of expenditures. As regards monetary and credit policies, the objective is to improve resource allocation for the productive sectors. Substantial gains are expected in the external sector through maintenance of an appropriate exchange rate, the buildup of international reserves, and the elimination of arrears. Moreover, the profile of the external debt is to be improved by limiting external borrowing to highly concessional terms and by initiating a debt rescheduling with Paris Club and other creditors.

As pointed out in the staff report, unsuitable ports, roads, and railways continue to constrain economic development; the adoption of corrective measures and expansion of investments in these sectors is of paramount importance.

The staff report has rightly acknowledged that "...the success of this adjustment strategy over the medium term depends on a temporary boost in external support." We hope that the international community--including the Fund and the World Bank--will help Tanzania to overcome its problems and to accelerate its economic development. Like our colleagues in the World Bank, we believe that debt relief would be helpful in improving the country's external payments position.

An important feature of the medium-term economic outlook is a gradual shift in the composition of Tanzania's exports. While the share of traditional exports was about 70 percent of total exports in earlier years, Table IX on page 64 of the staff report reveals that that share has fallen to 65 percent in 1986/87 and is anticipated to decline gradually over time to about 43 percent in 1993/94. It can hardly be denied that the maintenance of an appropriate exchange rate is important in achieving the above-mentioned satisfactory export performance. In this connection, the recent devaluation from T Sh 98 per U.S. dollar to T Sh 120 per U.S. dollar, which took place on November 4, 1988, is definitely a move in the right direction.

In addition to a suitable exchange rate, the envisaged expansion in exports necessitates more and uncomplicated access to traditional markets as well as to potentially new markets. Furthermore, not only should appropriate price competitiveness be pursued through a proper exchange rate management, but effective efforts and initiatives in developing nonprice or marketing factors such as packaging, promotion, and quality control at international market level are also of critical importance in achieving the objectives of satisfactory export performance, especially when the price elasticity of international demand is rather low.

On the social impact of the adjustment program, while we are comforted by the authorities' recognition of the importance of the basic social services and the development of the envisaged monitoring system, we believe that ways and means should be furnished to mitigate whatever transitory adverse impacts might emerge from the implementation of the adjustment program.

Mr. Dai made the following statement:

The Tanzanian economy has shown some signs of recovery in 1987/88. The rate of economic growth accelerated to 4 percent compared with 1.5 percent on average over the previous five years. While good weather contributed to the recovery, the Government's efforts in pursuing certain structural reforms and providing incentives to agriculture were also important factors. It is hoped that the authorities will take advantage of the opportunity brought about by the favorable weather conditions to correct the internal and external imbalances that still exist in the economy. The economic and financial program for the period 1988/89-1990/91 shows the firm determination of the authorities to reinforce economic policies that began in 1987/88 and to take new measures in the area of fiscal and monetary policies and structural reforms. Since I agree with the thrust of the program, I would like to confine my comments to a few general points.

First, the successive bumper crops of 1987/88 are encouraging and an important achievement in the economy, though they have brought about a number of problems in program implementation--especially in the financial field. In these circumstances, perhaps some part of the credit expansion might be justified and necessary since it reflects the increase in stock of agricultural products, which are of strategic importance to a poor agricultural economy like Tanzania. However, it is clear that improvement of the marketing system is one of the key areas to maintaining fiscal and monetary discipline. The Government has introduced several measures in this area by restructuring the marketing system. The steps taken toward establishing a strategic grain reserve as an independent buffer stock and reducing the role of the marketing boards as a way to improve economic efficiency while guaranteeing the national goal of food security are commendable. However, transferring the role of the marketing boards to private traders may take some time, as this process depends not only on the degree of maturity of the primary societies in dealing with private traders, but also on the ability of these traders to handle marketing of goods that are crucial to the economy. To ensure sustainable achievements in marketing system reforms, it is essential to eliminate as soon as possible those infrastructural bottlenecks that have hampered the development of the economy and created massive difficulties in macroeconomic management. In this context, I fully agree with the authorities' decision to place greater emphasis on rehabilitation of the transportation sector.

Second, exchange rate adjustment is, generally speaking, important for providing incentives to exporters. However, given the fact that the pricing system is not yet fully liberalized and the economy is heavily dependent on imports of food and other key commodities, I wonder whether the high pace of currency depreciation could lead to an unanticipated increase in the cost of imports, price inflation, and a consequent shift of subsidies by the Government from one channel to another. The elasticity of demand for primary commodities in the world market is another important factor in considering the effectiveness of devaluation in Tanzania. In this regard, I believe that overreliance on depreciation alone may not be adequately effective in the circumstances, as a flexible exchange rate policy must be accompanied by supportive reforms in other related areas. In my view, the tactics adopted by the authorities in adjusting their pace of economic adjustment in light of the social burden are quite understandable.

Third, given the fragility of the economy, particularly the continuous balance of payments difficulties over the medium term, active support from the international community in the form of the debt relief and exceptional financing is essential for Tanzania to attain external viability while stabilizing the balance of payments position over the medium term.

I share the staff's view that the policies presented by the Tanzanian authorities in the 1988/89 program warrant continued support from the Fund and I therefore give my support to the proposed decisions.

Mr. Yoshikuni said that he joined other speakers in endorsing the staff report and urging the authorities to implement the comprehensive economic program under the second-year structural adjustment facility arrangement. He had little to add to the staff report and policy framework paper and would therefore only make a few comments. First, despite many remarkable adjustments in the preceding years, performance under the first annual structural adjustment arrangement did not seem satisfactory. Nonobservance of both structural adjustment facility benchmarks and credit ceilings of the stand-by arrangement should be cause for great concern. Particularly worrisome was the fact that the slippages clearly pointed to the need for further efforts in structural policies, which in turn endorsed the need for a program under the second-year structural adjustment facility arrangement.

Second, Mr. Monyake had explained in his statement that the authorities had pursued the program very pragmatically, allowing some slippages when the social burden of the adjustment became unbearable, Mr. Yoshikuni noted. While he had sympathy for the formidable task before the authorities, such action gave rise to strong doubts about the reliability of the second-year program. With the termination of the stand-by arrangement, no effective mechanism existed to monitor periodically the macroeconomic policy adjustment process. In the circumstances, the authorities' firm commitment to the adjustment program was all the more important. It was therefore not advisable to predicate the adjustment process upon a pragmatic approach at the outset of program implementation. In that connection, he fully agreed with Mr. Enoch's view that the program should be implemented without any slippage in order to restore the confidence of the international financial community.

Finally, with respect to the contents of the program, he attached highest importance to exchange rate policy, Mr. Yoshikuni said, since the adjustment in real exchange rates envisaged in the program should be considered a minimum requirement. Further adjustment would likely be required, including the possible unification of exchange rates. In that context, he welcomed the recent strong measures to adjust the exchange rate as a step in the right direction. The interest rate policy should be reviewed constantly in order to realize and maintain a sufficient level of real interest rates, consistent with the aim of improving financial resource mobilization.

Mr. Templeman made the following statement:

Economic performance in Tanzania over the past year has been somewhat disappointing, both with regard to usual economic objectives and as measured against the specific targets and benchmarks established under the first annual arrangement under the structural adjustment facility. For example, inflation significantly overshot the target, the current account deficit exceeded its target, reserves fell short, and external arrears grew. The main policy weaknesses involved the exchange rate, interest rates, credit expansion, and producer prices--all important policy variables. Still, there were some important positive developments, notably, the recovery of real economic growth, including agricultural production; a lower than anticipated fiscal deficit--at least on a checks-issued basis; and progress in structural reforms in the tax, trade, and payments areas.

Despite some problems with the first annual arrangement under the structural adjustment facility, we can support the proposed second annual arrangement under the structural adjustment facility. The new program includes important macroeconomic measures as well as structural reforms. Indeed, performance over the past year amply demonstrates the close interrelationship between the two.

Under the new structural adjustment facility arrangement, it will be critical that the important reforms in marketing and pricing policies be implemented in such a way as to prevent a repetition of excessive monetary and credit expansion. Commitments to raise both deposit and lending interest rates are also the key to fostering savings and containing credit demand. We consider it very important that nominal rate adjustments be taken, if needed, to reach the goal of positive real interest rates--a failed target in the first annual structural adjustment arrangement. Also, it is unfortunate that the study of Tanzania's financial system was not completed last year and we look forward to its preparation this fiscal year, with the help of Fund technical assistance. It would be interesting to have that system explained more precisely.

In the fiscal accounts, better control over, and reordering of, public expenditure priorities will also be important in containing overall demand and in avoiding monetary financing of the deficit, while the planned reforms of customs duties, sales taxes, income taxes, and government fees are needed to contain the overall deficit within the ceiling of 10 percent of GDP to establish greater buoyancy in the tax system and to create a more appropriate set of economic incentives. The planned rise of 7 percentage points in the expenditure/GDP ratio in FY 1988/89 and the increase in the anticipated deficit ratio of 3 1/2 percentage points can be explained. However, the direction of movement and the absolute size of the deficit remain a matter of some concern even though the deficit can probably be financed without resort to domestic bank financing.

Very important reforms in the pricing, production, processing, and marketing of grains and beans are contained in the new annual structural adjustment arrangement, which includes a reduction in the scope of activities of the National Milling Corporation. Full implementation of these reforms presents a considerable challenge. Still, we concur with staff that complementary reforms will be needed in extending the freedom to sell these products to the primary societies, in introducing a system of quality control for maize, and in moving away from the panterritorial pricing system. Similarly, ambitious reforms in the industrial and transportation sectors are needed and are, to some extent, under way.

The most disappointing area of performance last year, and the one with the most uncertain medium-term outlook, concerns the balance of payments. The overshooting of the current account and overall deficits, the failure to meet the reserves buildup target, and the accumulation of additional external arrears over the past year owed something to the temporary suspension of exchange rate depreciation and highlight the importance of achieving an equilibrium rate. This is important if external targets are to be achieved over the program period and over the medium term--including the aim of eliminating accumulated arrears and liberalizing exchange and trade restrictions.

The staff projections of the balance of payments over the medium term continue to show an extremely difficult situation, even with rather positive assumptions. We share Mr. Enoch's concern about the size and duration of the anticipated financing gap. A realistic exchange rate and the reduction of structural bottlenecks to export growth will be key factors in containing the deficits within the rather optimistic assumptions regarding external debt relief and other foreign financial assistance. We hope that the planned new foreign direct investment code will be helpful in encouraging a larger nondebt component of current account deficit financing.

We welcome the explicit assessment of Tanzania's ability to repay the Fund, for example, on pages 25-26 of the staff report. While the debt service ratio to the Fund alone would peak at a rather modest 4 percent of exports in 1990-91, Tanzania's record of large and persistent arrears to other creditors in recent years does give some cause for concern.

Finally, as someone with relatively limited responsibility for structural adjustment facility-eligible countries, I was struck by a rather considerable amount of apparent duplication between the policy framework paper and the staff report. This relates mainly to the assessment of past economic performance. While such an assessment is clearly needed, I wonder whether a better way of packaging the documents could be developed to avoid duplication.

The Acting Chairman remarked that management was seeking ways to streamline the documentation presented to the Board, particularly for structural and enhanced structural adjustment facility cases. The length of material included in documentation for midterm reviews could also be streamlined.

The staff representative from the African Department noted that a number of Executive Directors had commented on the extremely difficult medium-term balance of payments outlook, and on the fact that even as far ahead as 1993-94, there was no prospect for a return to a sustainable balance of payments. The main reason was that in 1986, when Tanzania had entered into its first stand-by arrangement with the Fund, it had had a stock of external arrears in excess of $1 billion, which had been rescheduled by the Paris Club over a brief period of five years beginning in 1992. As a result, there was no way that Tanzania could return to balan ceof payments sustainability in the period 1992-97. That was illustrated in the table on page 63 of the staff report, which examined the medium-term balance of payments estimates. The repayment of medium- and long-term loans would increase from $150 million in the early 1990s to over $400 million in 1992. Moreover, by mid-1988, Tanzania still had a large stock of external arrears because no rescheduling had taken place for over a year. If payments were rescheduled over a period that began six or seven years in the future, the prospect for a return to medium-term balance of payments sustainability would not occur until the year 2000.

With respect to Mr. Posthumus's question on long-term borrowing, the staff representative indicated that the interest rate on 15-year to 20-year government bonds was 29 percent, which was low with respect to the 32 percent inflation rate over the past 12 months but fairly high in relation to the 18 percent inflation target for the following year, and considerably higher than the target of below 10 percent set for two or three years in the future. If the Government was to borrow at a fixed interest rate of 29 percent with a maturity of 15-20 years, and was successful in reducing the inflation rate to 10 percent, that would make it extremely difficult for the Government to service its domestic debt. Accordingly, the staff had recommended that the Government investigate the possibility of having long-term bonds with a variable interest rate.

Since the authorities seemed to believe that it was currently too difficult to introduce such bonds, it was probably better for the next 6-12 months that it refrain from borrowing with long-term maturities and only resume that borrowing once the inflation rate and, concurrently, the interest rate had been reduced.

In response to Mr. Prader's question on the trade-off between the speed of change in the exchange rate and the speed of the broadening of the open general license system, the staff representative explained that the goal was to avoid two extremes, one of which was to start immediately with a very broad open general license system. Given the current balance of payments situation, it would be extremely difficult to find an exchange rate that would equalize supply and demand immediately under an open general license system with a very large window. The other extreme was to postpone the introduction of an open general license system until external reserves were fairly high, which would result in a long delay. It had been decided, therefore, that the open general license system should be broadened over the next year or two, at which time the authorities should examine supply and demand under that system as a guide to the need for a change in the exchange rate. The speed with which the open general license system could be broadened was a question of judgment.

The reform of the financial sector was one of the main remaining issues in the Tanzanian case, and the authorities had asked the Fund to provide technical assistance on a review of the financial sector, the staff representative indicated. The Central Banking Department was sending a full team to Tanzania in January.

On the impact of the exchange rate on prices, Chart 1 on page 12a of the staff report was a useful starting point, the staff representative commented. There had been a very marked adjustment in real exchange rates in 1986-87, following a significant appreciation in preceding years. There was no question regarding the rigidity of the exchange rate in the years preceding 1986. In addition, comprehensive price control had led to an artificial compression of inflation. Once the exchange rate had been adjusted and prices had been liberalized, the result was a marked increase in the price index. From January to September 1988, there had been a small appreciation of the real exchange rate, which had artificially slowed down the rate of inflation; however, any gains would be canceled by October. That being said, the impact of the exchange rate on inflation should not be exaggerated because most goods, and consumer goods in particular, were not being imported at the official exchange rates, but rather, under the "own foreign exchange scheme." The domestic price of those goods reflected more or less the exchange rate in the parallel market. However, changes in the official rate did affect the price of petroleum products, which were imported at the official exchange rate.

On the inflation target, Mr. Tareen had commented that 18 percent in 1988/89 appeared optimistic, the staff representative recalled. However, a number of circumstances would be different that year. First, the change in the real exchange rate was much smaller than in 1986/87. Second, most of the price liberalization was over, with the last step having taken place in July of 1988. Third, producer prices of maize had been adjusted substantially in 1986/87. Fourth, the rate of increase in the money supply was expected to be much lower than in preceding years. The reform of the marketing system should lead to a rate of increase of credit to the marketing boards that was only one third the rate of the previous year.

It was true that the impact of a change in the exchange rate on import prices might lead to problems in the manufacturing sector, the staff representative from the African Department said. With the adjustment of the exchange rate, the parastatals and the manufacturing sector were currently being faced with much higher import prices. The value added was very small in relation to the value of imported intermediate inputs. In the past, parastatals had been able to avoid deficits because they had benefited from highly subsidized import prices. Now they would have to increase productivity, and that would be an important element of the overall adjustment.

Mr. Posthumus said that he had objected to the staff's advice that Tanzania finance its budget deficit on a short-term basis instead of long term. The staff had replied that long-term financing would entail substantial interest costs in the future while the Government aimed at a lower inflation rate. However, that analysis assumed that the staff would have to ask the Government to borrow at a long-term interest rate that was almost the same as the short-term interest rate, which was not true. If there was an anti-inflationary policy, the market would expect inflation to come down and would not demand high interest rates. If the authorities resorted to short-term financing alone, they would be feeding the market expectation and interest rates would remain high.

The staff representative from the African Department said that the difficulty was that one could not predict the rate of inflation. The staff had recommended a cut in the long-term interest rate on government bonds from 29 percent to, say, 10 percent based on the inflationary target. However, since there was no market in Tanzania for government bonds, it was difficult to decide what the long-term interest rate should be.

Mr. Posthumus said that the Government could not evade the cost of its own financing of high inflation. He recognized that when there was no market it was difficult to ascertain an appropriate interest rate for government bonds, but perhaps the Government should simply offer the bonds and monitor market reaction.

Mr. Monyake stressed that any economic models that were applied to cases such as Tanzania's had to be modified since they were developed for highly developed economies, and not for countries that were underdeveloped. The authorities considered that they had achieved a good working relationship with the Fund staff, and their goal was to complement rather than replace Fund staff expertise. That was the case, for example, in the areas of marketing and the exchange rate.

On the marketing of maize, which was the staple product, the authorities had argued strongly against a flexible producer price, which would compromise production goals and the national objective of food self-sufficiency, Mr. Monyake indicated. That was because the current pricing policy favored maize production in the southern remote areas, which were, in fact, those best suited to, and most reliable for, maize production.

On the exchange rate policy, the authorities had no difference of view with the Fund staff, and had undertaken to pursue the exchange rate policy as stipulated in the Minister's letter of intent to the Managing Director, Mr. Monyake continued. While the authorities and the staff also agreed on possible ranges of equilibrium exchange rate, the authorities considered that in Tanzania's situation, with the economy working well below capacity, the authorities should cautiously pursue an appropriate exchange rate level. It was for that reason that they were requesting the staff to be very realistic in its approach to the review of exchange rate policy, including the expansion of the open general license system for 1988/89.

Several Directors had expressed concern with the speed of adjustment, Mr. Monyake noted. However, Tanzania's economy required drastic changes, which could not take place suddenly if it was to avoid "withdrawal" symptoms. There would be political resistance to much of the adjustment, and political debate on such issues should be encouraged so that by the time the authorities took certain steps, they would have a sense of the political views that existed within the country. The slowing down that was suggested by the authorities should not be interpreted as a lack of enthusiasm on their part but simply a recognition of the current situation's realities. Indeed, it was sometimes necessary to prepare the economic climate gradually, at which point rapid adjustment could resume.

The Executive Board then took the following decisions:

1988 Consultation

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

2. Tanzania maintains restrictions on payments and transfers for current international transactions (described in SM/88/253) in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by external payments arrears are subject to approval under Article VIII, Section 2(a). The Fund notes the intention of Tanzania to eliminate these restrictions and encourages the authorities to remove them as soon as possible. In the meantime, the Fund

grants approval for the retention of these restrictions until the completion of the next Article IV consultation with Tanzania, or December 31, 1989, whichever is earlier.

Decision No. 9031-(88/173), adopted
November 30, 1988

Structural Adjustment Facility - Second Annual Arrangement

1. The Government of Tanzania has requested the second annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress of Tanzania in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper contained in EBD/88/318.

3. The Fund approves the arrangement set forth in EBS/88/227, Supplement 1.

Decision No. 9032-(88/173), adopted
November 30, 1988

The Acting Chairman made the following summing up:

Directors were in general agreement with the thrust of the staff appraisal and were encouraged by the progress Tanzania had made in recent years in several areas, including greater exchange rate flexibility, the liberalization of trade, and the recovery of economic activity, especially in agriculture. They expressed disappointment, however, at Tanzania's implementation of the structural adjustment financial program for 1987/88, particularly in relation to the restructuring of the agricultural marketing system and the slowdown in adjustment of the exchange rate. They noted that excessive credit to the marketing boards and to the cooperative unions, and to a lesser extent, the weakened fiscal position of the Government in 1987 and 1988, had resulted in credit and monetary expansion far in excess of program targets, with pronounced inflationary consequences. Directors also noted that processing and transportation difficulties had prevented the attainment of export targets, while lagging exchange rate adjustment, particularly the absence of adjustment during the first half of 1988, had increased the financial difficulties of the export crop marketing boards.

Directors noted with concern the medium-term balance of payments outlook, which they viewed as precarious, and agreed with the staff that it was imperative to proceed with adjustment policies vigorously, and to eliminate the structural rigidities that had been hampering economic performance. Many Directors held the view that Tanzania's circumstances strongly recommended a more forceful approach to adjustment in order to accelerate the beneficial effects of adjustment, and thus reduce the prospect that adjustment fatigue might set in.

Directors welcomed the recent adjustment of the exchange rate and the Government's commitment to effect further adjustments during the remainder of the program period. They indicated concern, however, that the programmed adjustment might not be sufficient to give the appropriate price signals to the tradable goods sector and thus bring about the needed reduction in external imbalances over the medium term. Directors therefore were of the view that exchange rate policy would likely need to be strengthened considerably, especially given the importance of proceeding with import liberalization. Directors welcomed the announced reform of the grain marketing system with the liberalization of marketing at the cooperative union level; the Government's assumption of direct responsibility in the management of the strategic grain reserve; and quality differentiation for strategic grain reserve purchases for 1989/90. With regard to export crops, they also welcomed the two-tier pricing system and the enhanced market flexibility. They emphasized, however, that the authorities would need to enforce rigorously the program's agricultural policy component to ensure that credit expansion to the agricultural sector remained in line with program projections. More generally, Directors encouraged the authorities to move further and faster toward freeing agricultural commodity markets.

Directors commended the progress realized in the fiscal field and urged Tanzania to continue with the implementation of reforms in the area of taxation. Those were made the more necessary by the need to provide a minimum of economic protection to the lowest income groups. Directors stressed that the authorities also needed to make progress on the expenditure side by implementing recommendations made in connection with the public expenditure review. Directors welcomed the authorities' efforts to improve financial intermediation, through an increase in interest rates and a reform of the interest rate structure on the one hand, and by studying ways of improving the financial system on the other. They stressed the importance for monetary policy to achieve positive real interest rates within the program period, both to encourage savings and to foster adequate resource allocation.

Directors expressed the hope that a satisfactory performance under the second year of the structural adjustment arrangement and a further strengthening of the adjustment effort would allow Tanzania to qualify for support under the enhanced structural adjustment facility. Indeed, some Directors hoped that discussions on a program that could be supported by an enhanced structural adjustment arrangement could start during the second year of the structural adjustment arrangement. Meanwhile, Tanzania's efforts deserved continued support from the international community in the form of grants, concessional loans, and debt relief.

It is expected that the next Article IV consultation would take place on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/172 (11/23/88) and EBM/88/173 (11/30/88).

4. CENTRAL AFRICAN REPUBLIC - 1988 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board agrees to extend the period for completing the 1988 Article IV consultation with the Central African Republic to not later than December 9, 1988. (EBD/88/120, Sup. 1, 11/22/88)

Decision No. 9033-(88/173), adopted
November 23, 1988

5. KOREA - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that with effect from November 1, 1988, Korea has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/88/338, 11/21/88)

Decision No. 9034-(88/173), adopted
November 28, 1988

6. TUNISIA - TECHNICAL ASSISTANCE

In response to a request from the Tunisian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/88/342 (11/23/88).

Adopted November 30, 1988

7. TURKEY - TECHNICAL ASSISTANCE

In response to a request from the Turkish authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/339, Correction 1 (11/22/88).

Adopted November 29, 1988

8. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 88/53 through 88/57 are approved. (EBD/88/336, 11/18/88)

Adopted November 28, 1988

9. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/287 (11/23/88) and EBAP/88/289 (11/28/88), by an Advisor to an Executive Director as set forth in EBAP/88/289 (11/28/88), and by an Assistant to Executive Director as set forth in EBAP/88/288 (11/28/88) is approved.

10. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/88/290 (11/28/88) is approved.

APPROVED: June 8, 1989

LEO VAN HOUTVEN
Secretary