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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/179

3:00 p.m., December 12, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	Zhang Z.
	D. C. Templeman, Temporary
	A. Rieffel, Temporary
J. de Groote	
E. T. El Kogali	P. E. Archibong, Temporary
	R. J. Lombardo
	E. Ayales, Temporary
	R. Marino, Temporary
	M. B. Chatah, Temporary
	O. Kabbaj
	B. Goos
	R. Wenzel, Temporary
	E. Kiriwat
	L. E. N. Fernando
	L. M. Piantini, Temporary
	D. McCormack
Mawakani Samba	J.-C. Obame, Temporary
Y. A. Nimatallah	
	M. Fogelholm
	D. Marcel
	G. Serre, Temporary
G. A. Posthumus	G. P. J. Hogeweg
	C. Y. Legg, Temporary
K. Yamazaki	N. Adachi, Temporary
	N. Kyriazidis

C. Brachet, Acting Secretary
D. de Vos, Assistant

Also Present

IBRD: P. Alba, T. W. Allen, R. Clement-Jones, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; G. E. Gondwe, Deputy Director; A. Bourhane, S. E. Cronquist, R. E. Daumont, M. G. Fiator, C. D. Pham, E. Sacerdoti, E. M. Taha. Asian Department: S. P. O. Itam, H. Vittas. Exchange and Trade Relations Department: H. B. Junz, Deputy Director; A. Basu, S. Kanesa-Thasan, G. R. Kincaid. Fiscal Affairs Department: A. Cheasty. Legal Department: H. Elizalde, J. W. Head, A. O. Liuksila, J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; J. Hicklin, S. H. Hitti, Z. Iqbal, P. van den Boogaerde, C. A. Yandle, M. Yaqub, M. Zavadjil. Treasurer's Department: T. Leddy, Deputy Treasurer; J. E. Blalock, D. V. Pritchett, P. S. Ross. Office of the Managing Director: P. Shome. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. Al-Jasser, S. M. Hassan, P. D. Péroz, N. Toé. Assistants to Executive Directors: S. Appetiti, F. E. R. Alfiler, H. S. Binay, T. T. Do, F. El Fiky, B. R. Fuleihan, J. Gold, S. Guribye, M. A. Hammoudi, A. Hashim, C. L. Haynes, J. Heywood, C. J. Jarvis, P. Kapetanović, K. Kpetigo, M. A. Kyhlberg, V. K. Malhotra, T. Morita, W. K. Parmena, M. J. Shaffrey, Shao Z.

1. NIGER - 1988 ARTICLE IV CONSULTATION, AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors resumed their consideration of the staff report for the 1988 Article IV consultation with Niger and Niger's request for an enhanced structural adjustment arrangement (EBS/88/237, 11/21/88; Cor. 1, 12/7/88; and Cor. 2, 12/9/88), together with a policy framework paper for Niger (EBD/88/335, 11/18/88). They also had before them a statistical annex updating the previous background paper on recent economic developments in Niger (SM/88/265, 12/5/88).

Mr. Kabbaj made the following statement:

> As set out in Mr. Mawakani's opening statement and in the staff papers, the authorities have made commendable efforts to overcome the economic and financial imbalances that have arisen in the economy since the early 1980s. These imbalances have been due mainly to the drop in world demand for uranium, the deterioration in Niger's terms of trade, and the severe drought that has adversely affected the economy for many years.
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> Through the implementation of a package of structural measures, including the rehabilitation and privatization of a number of public enterprises, and by following appropriate demand-management policies, the authorities have succeeded in reducing substantially the prevailing distortions in the market and price mechanisms. These measures were reinforced by some fiscal policy measures, such as improvements in budgetary management, the broadening of the tax base, and, to some extent, by the introduction of a value-added tax.
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> Fortunately, favorable weather conditions in 1988 have helped these measures to generate encouraging results. The economy is estimated to have grown by about 7.1 percent in 1988, compared with a decrease of 0.7 percent in 1987, while the rate of inflation for the first half of 1988 was about 1.6 percent above its 1987 level, and is expected to increase by about 2.6 percent for the whole year. Moreover, the fiscal deficit on a commitment basis, excluding grants, is estimated to be lower than targeted; and the external current account deficit, including official transfers, is expected to be 2.9 percent of GDP, compared with 4.1 percent in 1987.
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> As shown in the policy framework paper, the thrust of the authorities' plan is to diversify the economy, to enhance production and exports, and to strengthen marketing and pricing policies. These objectives are appropriate and will result in improved competitiveness in the whole economy.
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> Similarly, the authorities are giving special attention to the social impact of the reforms. They are determined to raise

the standard of living, especially that of the lower-income classes, as well as to improve the status of public education and the national health service.

However, the large budget deficits that the Government is facing in 1988/89 are worrisome. Given this situation, it seems that the authorities have no choice but to make further recourse to foreign resources to finance the public sector investment program. To cope with the problem, I hope that the authorities will be able to implement measures to boost domestic resources. In this respect, I welcome the restructuring of the national development bank (BDRN), the carrying out of the banking system study, and the implementation of the latter's recommendations in consultation with the Fund and the World Bank with the aim of mobilizing potential savings and of improving resource allocation.

The estimated trade deficits over the period 1988-93, owing to the depressed state of the world uranium market, are a cause for concern. I therefore again underscore the importance of expanding and diversifying the productive base; joint efforts by the authorities and the World Bank are of vital importance to this end.

The success of the envisaged plans and measures are highly dependent on donor countries' commitments, as well as on the financial and technical assistance of international organizations, particularly that of the Fund and the World Bank. In view of Niger's development and reform program, I warmly endorse the proposed decision.

Mr. Adachi said that Niger had made steady adjustment efforts and impressive progress under Fund-supported arrangements since 1983. The major structural reforms had improved the efficiency of the economy, and all performance criteria had been met through September 1987. With the assistance of favorable weather, the Nigerien economy was expected to enjoy high growth and low inflation rates in 1988. However, Niger was still facing a fragile balance of payments outlook, being overshadowed by the unfavorable prospects for uranium exports and by the uncertainty with respect to agricultural output. Despite the authorities' substantial efforts thus far, those should be intensified to bring the economy to a growth-oriented adjustment path. In that respect, he welcomed the authorities' commitment, as emphasized by Mr. Mawakani in his opening statement. It was also gratifying that further rehabilitation of public enterprises was planned in the 1988/89 program, and that pricing policy would be liberalized further.

However, the country's heavy reliance on external assistance was a serious cause for concern, Mr. Adachi remarked. The current account, excluding official transfers, as well as the trade balance were projected to deteriorate over the program period, yet external viability was expected to be restored in 1992. The assumptions underlying the baseline scenario no doubt pointed to the downward risks. Any slowing in the disbursement of foreign budgetary assistance, unexpected lower exports, or drought could jeopardize the attainment of the program's objectives.

The uncomfortable balance of payments prospect underscored the necessary role for prudent fiscal policy, Mr. Adachi commented. In that respect, the fiscal revenue shortfalls in 1988 were a matter of concern; and although the strengthening of the tax administration was expected to yield substantial benefits, the 1988/89 program could be excessively ambitious on the revenue side. He was concerned that the proposed program, which incorporated a significant increase in public investment outlays, could be overly optimistic. Nevertheless, he greatly welcomed Mr. Mawakani's indication that the authorities were willing to take additional measures in case of slippages, and also the information just provided by the staff.

It was his chair's firm belief that resources under the enhanced structural adjustment facility should support only far-reaching medium-term adjustment programs, embodying both strong macroeconomic and structural measures, Mr. Adachi pointed out. It would be regrettable if the proposed program fell short of expectations. On condition that the authorities developed and implemented supplementary measures--especially for strengthening the fiscal position--and taking into consideration the country's good performance record, he supported the proposed decision.

Mr. El Kogali made the following statement:

> I fully endorse Niger's program under the enhanced structural adjustment facility, as it is the most appropriate facility in view of the country's structural weaknesses and the authorities' commitment to structural adjustment, as amply demonstrated by their performance under the past two structural adjustment arrangements. The focus of external assistance to Niger should be on strengthening the economic and social infrastructure, because the country's fragility in this respect is more pronounced than in most African countries. Such weakness is evidenced by the estimated ratio of savings to GDP in 1988 of 4.2 percent, investment to GDP of 9.8 percent, tax revenues to GDP of 9.9 percent, and by the adult literacy rate of about 14 percent and the primary school enrollment ratio of 25 percent. At the same time, while 70 percent of GDP is derived from the unpredictable informal sector, the country depends on uranium for 80 percent of its export earnings, for which the future is dim. Surely, under these circumstances, the authorities' must give priority to the restructuring and diversification of the economy. It was therefore gratifying to note from Mr. Mawakani's opening statement that the authorities are according top priority to diversification.

The authorities are to be commended for the tremendous progress made toward restructuring and diversification in 1987/88 under the second structural adjustment arrangement, especially in the areas of deregulation and public enterprise reform. I agree with Mr. Mawakani that substantial progress was made in the liberalization of prices, marketing, and trade policies. At this juncture, the authorities have made a prudent decision to broaden the scope of structural reforms while converting to an enhanced structural adjustment arrangement, which gives them greater access to Fund resources--150 percent of quota--as well as another three years of collaboration in their restructuring effort with the Fund, the World Bank, and other creditors. This should provide, inter alia, badly needed financial and technical assistance and debt relief. I agree with the thrust of the envisaged program and with the staff appraisal. However, greater stress should be placed on structural policies than indicated in the staff papers, with increased priority being given to rural development, followed by public investment, and public enterprise reform.

Since the potential for broadening and deepening the production base and for diversifying exports lies in rural development, I welcome the authorities' measures under the 1988/89 program for investment in this sector, and those aimed at improving natural resource management. In this respect, I have noted World Bank Directors' concern about the impact of the deteriorating environmental conditions on agriculture, and I join them in urging the authorities to improve the integration of agriculture, livestock, research, and extension services. I also see the need for considerable emphasis on primary, adult, and vocational education, and on other extension services by the Government in order to achieve concrete results in rural development. Whatever restructuring is done to the public investment program or to the financial system to reorient investment toward rural development, such resources can only be utilized fruitfully once education and training levels have been elevated reasonably. I hope that the authorities will complete the deregulation of pricing and marketing to promote efficiency and to enhance the role of the private sector.

I fully support the progressive reduction of the budget deficit, and have noted that the deficit will expand slightly in 1988/89, owing entirely to increased investment expenditure. However, given the low level of development in Niger, external financing will continue to play a crucial role in the medium-term development of the economy, as the ratio of domestic savings to GDP is projected to rise to only 5.9 percent by 1991. In this connection, I support the authorities' endeavors to broaden the tax base--at least, to capture the informal sector--and to strengthen tax administration, which should result in some increase in the ratio of fiscal revenues to GDP.

With respect to the ongoing reform of the public enterprise sector, I commend the authorities for their exemplary performance thus far, especially in the legal and institutional field, and in the preparation of contract plans. They should proceed with care and complete the entire program of rehabilitation and privatization as scheduled; such action should invigorate and give more room to private enterprise, especially given the background of deregulated prices and the liberalized external trade environment. I support the proposed decision.

Mr. Rieffel made the following statement:

The authorities have shown commendable determination in implementing macroeconomic and structural reforms over the past five years. It is gratifying that they have been able to reach agreement with the staff on access to the enhanced structural adjustment facility. I support the proposed decision, and generally concur with the staff appraisal.

Beginning with performance over the past year, I join other Directors in expressing disappointment over the slippages in fiscal policy that occurred. It is encouraging, nevertheless, that the program remained on track. The delays in implementing some components of the public enterprise restructuring program were also disappointing, particularly the fact that benchmarks relating to performance contracts with some enterprises were missed. Given this slippage, it is surprising to find that there are no performance benchmarks relating to the public enterprise sector under the first annual enhanced structural adjustment arrangement.

Looking ahead, the program objectives in the fiscal area are clearly of central importance. The policies for 1988/89 seem generally adequate; but I agree with the staff that it is essential to accelerate efforts to strengthen tax administration. On the expenditure side, I have the impression that there has also been some slippage in the completion of a review of the civil service. I will be interested to hear more about how the results of the review will be implemented at the time of the midterm review of the program.

With respect to structural policies, I continue to place considerable importance on reforms in three areas. First, in the area of pricing policy, I was hoping that under an enhanced structural adjustment arrangement it would be possible to move more quickly to eliminate preset profit margins and fixed price ceilings. In particular, is it appropriate to maintain fixed price ceilings for petroleum products? Second, in the area of parastatal reform, both the policy framework paper and the program under the first annual enhanced structural adjustment arrangement list quite a few measures that will be taken. Still, it is difficult to get a sense of the pace envisaged toward achieving the objective of "improving the efficiency of the sector and reducing its size." The staff should explain what the obstacles are to faster progress in the parastatal area. Third, there is relatively little emphasis on financial sector reform in the 1988/89 program, although a study of the banking system is due to be completed before the end of the program year. The recommendations of this study should be implemented with some urgency to reinforce the broad effort to increase the role of the private sector in Niger's economy.

Turning to the medium-term outlook, I have noted the staff view that balance of payments equilibrium could be reached in 1992. It is somewhat of a cause for concern, however, that the major factor in the strengthening of the balance of payments appears to be substantial increases in official grants and net capital flows from public sources. By contrast, the improvement in foreign exchange earnings appears quite modest, and may even vanish if uranium prices fall below the projected level.

I have two comments of a procedural nature. While there are reasonable structural benchmarks under the first enhanced structural adjustment arrangement, at least one structural target should be given the status of a performance criterion--as has been done in other cases--to underscore the importance of structural reforms in reaching the economic objectives of the country.

In a different vein, I appreciate the information provided in the staff paper, both in the section on the medium-term outlook and in the staff appraisal, on Niger's capacity to repay the Fund. Such information should be pulled together, as has been done here in the staff papers, on all requests for the use of Fund resources. In the case of requests for enhanced structural adjustment arrangements, however, it would be useful to look beyond the normal horizon of three to five years to get a sense of how large repayments to the Fund will be when the principal payments on the enhanced structural adjustment loans begin.

I hope that the authorities will continue their economic reform efforts with determination, and I am pleased that they have been able to take advantage of the enhanced structural adjustment facility.

The staff representative from the African Department said that the Government's net position with the banking system was targeted to improve considerably under the program, and that the enhanced structural arrangement resources would assist in that respect. Nonetheless, the staff and the authorities were concerned about the deterioration of the Government's deposit position with the Central Bank and were most eager to see a reconstitution of the position to that held in the past.

Both the Fund and the World Bank staff believed that business confidence had been restored substantially over the previous 12 months, owing partly to the tax reform and to the reduction in tariff and value-added tax rates, the staff representative noted. The latter had affected the fiscal budget negatively, but had been received very well by the private sector. A private sector round table in June had highlighted the relatively favorable circumstances of the business community.

It was neither easy to mobilize resources from the private sector nor to sell public enterprises, and thus it was the view of the Bank that some delays in the privatization program were not unexpected, the staff representative continued. In any event, the delays involved the implementation and finalization of privatization agreements, not the postponement of sales. The authorities were actively conducting negotiations to sell public companies and, like the Fund and the Bank staff, believed that the privatization effort was well monitored and progressive. The banking sector study was to be completed during the program year, during which the staff hoped that the target of privatizing 11 companies would also be met. In that connection, a recently returned Bank mission had indicated that the schedule of measures in respect of Niger's development bank had been implemented and should lead to a meeting of potential private partners in 1988. An evaluation of those measures, together with that of the actions taken in the civil service, would be key elements of the upcoming program review. Some slippages had arisen in implementing the latter actions, but they had been related to delays in completing the relevant study, not to insufficient determination on the authorities' part.

With respect to the concern expressed about the marketing inefficiencies of public agencies in the agricultural sector, it should be noted that an important structural reform of the agency in charge of cereals marketing aimed at completely excluding that agency from such marketing, and therefore at relying on private channels to market cereals. The main cereals agency was now confined to managing food security, which was a large task in itself. The Bank viewed the reform of the cereals marketing agency as a significant positive step, although some inefficiencies might continue to exist given that the private sector was not necessarily very competitive. Moreover, legal questions had to be considered carefully to avoid replacing one monopoly with another.

The import and export projections under the enhanced structural adjustment arrangement were somewhat different from those under the structural adjustment arrangements because of the new base year--1988--used to make projections under the former, the staff representative explained. The actual amount of imports in 1988 had been much less than the relatively large amount projected under the structural adjustment arrangement, owing to delays in the investment program; but such investment would accelerate, and therefore import growth was projected to be faster over the new three-year program than envisaged previously. The projected increase in imports was consistent with the growth orientation of the adjustment program and thus with the authorities' investment effort, provided that the latter was monitored well and allocated efficiently. With respect to the export projections, although uranium sales to foreigners were projected to grow somewhat less under the envisaged than under the former program, the 12 percent growth rate was not insignificant and was realistic. Moreover, including the data for livestock and agricultural exports in 1987/88, total exports were currently projected to grow at a more moderate pace than under the earlier structural adjustment arrangements; and the current account deficit would be moderately larger.

Niger had a comfortable reserve position, the staff representative added. Reserves would increase during the program period by about SDR 10 million; and, although that rise would be less than under the structural adjustment arrangement, the ratio of reserves to imports would decline only slightly from more than 5.6 months of imports to 5 months at the end of the program period. Reserves would have to play the role of a contingency fund to offset risks to the program, such as drought or lower than projected uranium prices. It was appropriate to provide for some strengthening of reserves in absolute terms for a landlocked country like Niger with a balance of payments outlook that was subject to some downside risks.

The program's fiscal projections had struck an appropriate balance between extremes, the staff representative remarked. The fiscal adjustment had to be ambitious, particularly with respect to revenues, which were targeted to increase by an average of 10 percent a year. The revenue measures had been well elaborated for the first year of the program; but, for the latter two years, they would have to be defined in a manner based on the experience gained with the tax reform introduced in 1988/89. The revenue targets were ambitious, but not to an inappropriate degree that would have been difficult to back up with effective measures. The staff had stressed the need for, and the authorities were very committed to, reducing the budget deficit, especially excluding foreign financed capital outlays. The latter consideration was an essential element of the program, as the fiscal budget relied excessively on external budgetary assistance.

The staff agreed with Mr. Goos that the investment program would have to be adjusted downward if capital inflows were lower than envisaged, the staff representative commented. In a sense, the link between the two would be automatic given that a large fraction of investment in Niger was financed from abroad. Indeed, in the past, a common reason why investment targets had not been achieved was that foreign disbursements had been lower than expected--which had obviously not affected the Government's budget position, excluding foreign financing. Allocations for education and health expenditures had declined in 1987/88, but the staff certainly did not expect that actual disbursements in those expenditure categories would also fall, as there were still unallocated funds in the treasury account and as the various expenditure categories of the budget were forecast to increase in line with the program's overall fiscal projections.

The staff believed strongly that the core of the program lay in the effort to diversify out of the uranium sector, which was subject to uncertain international prices, the staff representative from the African Department concluded. The investment and diversification program monitored by the World Bank should ensure an adequate strengthening of the agricultural sector and the diversification of exports over the next three years. In that connection, an important structural measure taken by the authorities had been the elimination of export taxes, which had been stressed in the staff paper. That action would have a favorable effect on exports, and on incentives in a number of areas in the economy.

Mr. Mawakani said that he entirely supported the comments made by the staff representative. He confirmed that the authorities were committed to continuing their adjustment effort. The authorities had already decided to proceed with privatization; and despite the fact that some delays had occurred in implementing the privatization program--arising from the need to evaluate the assets of public enterprises and of the possibilities to pay--that delay had not been of the authorities' making, but had been due to existing circumstances. Moreover, some progress had been achieved, and was continuing with respect to the reform of the pricing and marketing arrangements, although it was necessary to keep in mind that if such reform was too fast, the population's social welfare would suffer.

During his visit to the Fund in November, the Secretary of State for Budget had noted that the fiscal reform had been implemented, but that, owing to a shortfall in revenue and in spite of the authorities' consequent adoption of measures to reduce expenditure, the fiscal deficit target could not be achieved under the current program, Mr. Mawakani continued. The authorities were well aware of the difficulties and would take all necessary measures to correct the situation.

Mr. de Groote added that he wanted to welcome the new Director of the African Department to the Board, after the most successful completion of his former ministerial responsibilities, and his agreement to offer his experience to the Fund in the crucial area of Africa, where the credibility of Fund policies was being put to the test.

The Chairman made the following summing up:

> Executive Directors agreed with the thrust of the views expressed in the staff appraisal. They commended the authorities for the adjustment programs implemented since 1983 and the substantial progress achieved in reducing the structural distortions and constraints impeding growth, as well as in keeping aggregate demand in line with available resources. They welcomed the progress achieved in implementing further structural reforms under the 1987/88 program supported by the structural

adjustment facility, notably the reduction in the scope of price controls and of intervention by official agricultural agencies--thereby permitting greater flexibility in the agricultural pricing system--and the rehabilitation and privatization of a number of public enterprises. Directors noted with satisfaction that there was a resurgence of economic activity in 1988 after the drought-related decline in 1987, that the external position had strengthened, and that the inflation rate had declined significantly. However, they expressed concern over the continuing weakness of the Government's budgetary situation, as evidenced by the relatively low ratio of taxes to GDP. Hence, they emphasized the need to reinforce tax administration and to widen the revenue base.

With regard to the medium term, Directors noted that Niger's growth and balance of payments prospects remained difficult, because of the unfavorable prospects for uranium demand, the limited base of non-uranium exports, and the vulnerability of agriculture to climatic conditions. In view of these circumstances, they welcomed the decision of the authorities to reinforce the adjustment process, with the support of arrangements under the enhanced structural adjustment facility. They emphasized, however, that the envisaged program would require careful monitoring given the constraints under which Niger was operating, and that an even stronger effort than contemplated by the program might indeed well prove necessary.

The Directors noted that the Government's new program placed emphasis on stimulating private sector activity, diversifying agricultural production, completing the restructuring of the public enterprise sector, rehabilitating the banking sector, and continuing to improve domestic resource mobilization and public resource management. Directors welcomed the liberalization measures that had already been taken and noted their favorable impact on agriculture. They stressed the importance of eliminating the remaining restrictions in the price system and further simplifying external trade regulations in order to encourage economic activity and diversification in a competitive environment. While welcoming the actions under way to complete the privatization of nonstrategic public enterprises, Directors urged the authorities to move quickly to rehabilitate the other key public enterprises and the banking sector.

Directors emphasized the importance of giving high priority to achieving the projected improvement in the overall fiscal position. They stressed that the rigorous implementation and monitoring of the envisaged revenue measures were critical so that corrective actions could be taken promptly if any slippages were to occur and reliance on foreign budget support could diminish gradually. Moreover, the revenue effort would have to be sustained over the three-year period in order to widen the revenue base and to increase the ratio of tax collections to GDP. On the expenditure side, Directors pointed to the importance of restraint in current spending and of allocating more resources for recurrent costs and for sectors such as education and health. With regard to the public investment program--which is to rise over the program period--they stressed the importance of efficient allocation of resources so as to support export diversification and facilitate the attainment of external viability over the medium term.

Directors noted that Niger was expected to continue to benefit from significant external financing on concessional terms and from grants in support of the investment effort, and thought that such assistance was justified given the authorities' track record and their resolve to pursue, and intensify if necessary, sound adjustment policies.

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

The Executive Board then took the following decision:

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

2. The Fund notes the updated policy framework paper for Niger set forth in EBD/88/335.

3. The Fund approves the arrangements set forth in EBS/88/237, Supplement 1.

Decision No. 9039-(88/179), adopted
December 12, 1988

2. CENTRAL AFRICAN REPUBLIC - 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 the Central African Republic, and the Central African Republic's request for the second annual arrangement under the structural adjustment facility (EBS/88/228, 11/9/88), together with a policy framework paper for the Central African Republic (EBD/88/320, 11/8/88). They also had before them a background paper on recent economic developments in the Central African Republic (SM/88/257, 11/28/88).

The Managing Director made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their December 1, 1988 discussion in Committee of the Whole of a paper entitled "Central African Republic - Policy Framework Paper."

1. Executive Directors expressed their general support for the adjustment program of the Government of the Central African Republic as described in the policy framework paper discussed at the meeting of the Committee of the Whole on December 1, 1988. They expressed admiration for the efforts and the continued commitment of the authorities to the program despite unfavorable external circumstances, in particular the deterioration of the terms of trade and the appreciation of the CFA franc. They encouraged the authorities to continue their resolve in spite of the failure to achieve the growth targets of the first policy framework paper. It was generally recognized that the Central African Republic faces a long-term effort to establish sustained growth. Indeed, Directors expressed concern that the scenario presented in the policy framework paper did not show adequate growth, and questioned whether the targets retained in the policy framework paper did not imply excessive social costs.

2. Serious concern was voiced by the Directors about the impact of liberalization while the currency is appreciating. The staff explained that efforts were under way to support a regional approach to this problem, working with the six countries of the UDEAC customs union who all share the same currency.

3. The Directors indicated that the Fund and Bank staff must make additional efforts at analyzing and discussing the exchange rate issues and/or alternative measures to stimulate growth and enhance competitiveness with the appropriate regional authorities.

4. Directors noted the progress made in the major components of the adjustment program. The reform in civil service was particularly encouraging, despite some implementation delays. They urged the Government to pursue this effort which is essential to the twin objectives of reducing the wage burden on the budget and improving the quality of public administration. This readjustment in budgetary allocations should permit more spending on material and services, thereby reinforcing the quality of government services, in particular education and health.

5. The Directors voiced their concern that the policy framework paper did not include any statement on environmental issues, and urged that future policy framework papers should give adequate attention to environmental concerns.

6. The program will cause hardship to the population, particularly those living in cities. The efforts of the Government to alleviate some of this hardship through a program of assistance for civil servants that choose to participate in the voluntary departure program or are dismissed is much appreciated, but may not be enough. Directors also noted that the deregulation of economic activity should substantially assist in invigorating the private sector where most employment creation will have to occur in the years to come, but may pose some burdens on particular segments of the population. More attention needs to be given to the social dimensions of adjustment.

7. The financing needs of the economy of the Central African Republic will be significant in the 1988-91 period, but are expected to fall off after that. Directors expressed the hope that the donor community will support the adjustment program with sufficient amounts of concessional financing. Debt relief and quick disbursing loans, within the context of the Special Program of Assistance for debt-distressed countries, should provide significant contributions, while continued support for growth-oriented investment projects will remain essential.

The staff representative from the African Department said that on December 8, the authorities had provided the staff with information on fiscal budget developments during the first nine months of 1988, which indicated that significant revenue shortfalls had emerged, in part owing to falling imports and to continued structural problems. For the year as a whole, despite the measures adopted at the end of August, the revenue shortfalls were projected to be CFAF 4 billion, equivalent to 1.2 percent of GDP; that shortfall would increase the budgetary financing gap from the equivalent of 2.9 percent of GDP assumed under the present program to about 4 percent of GDP. Fiscal revenue projections for calendar year 1989 had also been revised downward, resulting in a fiscal deficit equivalent to 12.4 percent of GDP compared with the 10.9 percent foreseen earlier. The financing gap for the second half of the program here would therefore also be larger than programmed.

The staff expected that the financing gap could be closed despite the more adverse fiscal revenue trends, the staff representative observed. Discussions with the authorities and the Secretariat of the Paris Club on December 9 and 10 indicated that the budget deficit could be financed fully during the program, assuming that a standard Paris Club rescheduling would take place and that disbursements from the European Communities (EC) and under the Stabilization System for Export Earnings (STABEX) would be made. A large unprogrammed disbursement under STABEX had been made already in 1988, and others were expected during 1989 to cover shortfalls in coffee, cotton, wood, and tobacco exports. The EC had also committed financial resources to be disbursed in early 1989 in the event of a Fund-supported adjustment program. Furthermore, the Central African Republic was eligible for resources under the World Bank's Special Program of Assistance.

To ensure that the authorities' expectations would be met and that their adjustment efforts were strengthened appropriately, a Fund mission would visit Bangui in early 1989, the staff representative commented. The mission would review the 1989 fiscal budget, assess the outcome for the 1988 fiscal budget, and revise the medium-term outlook. A fiscal technical assistance mission was expected in Bangui at about the same time, mainly to review the general income tax, but also to examine the structural problems of revenue collection. In addition, the technical assistance provided by France to the Customs Department was to become fully operational in early 1989. In early February, the World Bank planned to discuss the result of the public expenditure review mission that took place in October/November 1988 and to prepare a seminar on public sector resource mobilization, to be held later during the year. The Bank had also scheduled a structural adjustment loan supervision mission for March 1989.

The information provided by the authorities also demonstrated that two indicative targets relating to the reductions in external and domestic payments arrears had not been met in September, owing partly to delays in obtaining debt rescheduling and in receiving external financing, the staff representative noted.

According to information provided by the authorities and by the World Bank, a number of actions had been implemented as scheduled under the timetable for structural measures, while others were encountering some delays, the staff representative remarked. Progress in that area was being monitored closely by the Bank and appeared to be broadly satisfactory.

Mr. Obame made the following statement:

> The staff report for the 1988 Article IV consultation with the Central African Republic and request for arrangements under the structural adjustment facility as well as the accompanying documents provide an accurate description of the economic difficulties facing the country and the adjustment efforts undertaken to tackle them. The authorities broadly endorse the staff's analysis of policy implementation and the economy's prospects for the medium term.
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> The overall performance of the economy in 1987 was mixed and somewhat below expectations. In the real sector, despite the substantial growth in the primary sector reflecting mainly

higher subsistence crop production and a sharp increase in construction activity in the secondary sector, real GDP growth is estimated to have decelerated further, reaching only 1.4 percent in 1987, compared with a target of 3.3 percent under the program. This outcome is due partly to the stagnation in manufacturing, mining, and utilities production, as well as in public service activities.

Reflecting the slowdown of overall economic activity, fiscal and external performance were less than satisfactory. Thus, in the fiscal sector, the overall government deficit, on a commitment basis and excluding grants, exceeded the program target by more than 2 percent of GDP owing to a significant decline in fiscal revenue. Also, in the external sector, the large deterioration in the C.A.R. terms of trade led to a deterioration in the external current account deficit that was significantly higher than programmed.

These rather unfavorable financial developments should not mask the satisfactory implementation of structural measures over the past two years, as can be seen in Table 13 of the staff report (EBS/88/228). Indeed, remarkable achievements have been made in some key policy areas. For example: the setting up of a three-year rolling investment program; the creation of a research service for rural development; the liberalization of prices and the trade regime; the abolition of import licenses and quotas; the elimination of restrictions on the marketing of local products; and the containment of the wage bill.

Furthermore, substantial efforts have been made in the rehabilitation of the parastatal and the agricultural sectors. For instance, in the parastatal sector, the Government has launched several actions leading to the reorganization of the liquidation management and privatization procedures of several public enterprises. Additional financial measures have also been implemented to rehabilitate the main public utilities. As regards the agricultural sector, among other measures, the marketing of foodcrops has been liberalized and a new policy related to wood production and the promotion of the export of wood products has been put in place.

Despite the progress made so far, particularly in the area of structural reforms, the economy continues to face structural and financial imbalances. The authorities are well aware of these imbalances and intend to pursue their ongoing adjustment efforts and policies, as described in the policy framework paper covering the period 1988-90 (EBD/88/320).

As indicated in the policy framework paper, the major macroeconomic objectives over the next three years are: to achieve an annual rate of growth of real GDP of 2.5 percent; to contain the rate of inflation as measured by the GDP deflator to about 2 percent a year on average; and to reduce the external current account deficit, excluding official unrequited transfers, to about 13 percent of GDP by 1991.

To achieve the above objectives, the authorities view the need to speed up the ongoing structural reforms as crucial. They are therefore continuing progressively to open the economy to market forces by encouraging private sector initiative and by reducing the role of government in the production and trade sectors. Their strategy will focus on the following five areas: the improvement of planning procedures and project selection for public investment; the enlargement of the productive base of the economy with continued implementation of agricultural programs and industrial policies; the improvement and the strengthening of public finances through, inter alia, the implementation of tax and tariff reforms; the reinforcement of the civil service and educational system reforms; and the acceleration of the rehabilitation of parastatals.

Consistent with the orientation of the medium-term framework under the second structural adjustment arrangement for 1988/89, which started in July 1988, the following objectives have been set: to achieve a real growth rate of 2 percent; to contain the rate of inflation to about 1 percent; and to reduce the external current account deficit to a level close to 18 percent of GDP.

Even though the growth objective is too conservative relatively speaking, the authorities will place emphasis on pursuing structural reforms with a view to fostering higher growth rates in an environment more favorable to the private sector. At the same time, they will be focusing on the implementation of more stringent fiscal policy that involves both revenue-raising and expenditure-containing measures.

Structural reforms under the 1988/89 program are well detailed in the staff report and encompass various areas. In the agricultural sector, most of the structural measures are aimed at enhancing the efficiency and production of the cotton, coffee, forestry, and foodcrop sectors. For instance, the efforts to restructure SOCADA (the cotton development agency) are being pursued under the emergency program established in late 1986. Similarly, the authorities are streamlining the operations of CAISTAB (the stabilization fund for coffee) under the program supported by a World Bank structural adjustment loan, by reducing its export activities and by leaving exporting functions to the private sector. In the forestry sector, rebate of export taxes on wood products and of import taxes on spare parts and forestry equipment are in force.

As underlined in the staff report, the most far-reaching structural measure to be implemented during the two-year period 1988-89 is a phased reduction of about 2,000 civil servants. Despite the high social and political costs of such a measure, the authorities are taking steps to implement it. To that end, laws and decrees relating to voluntary departures and to the personnel pool (redundant personnel in each ministry) were issued in August 1988; the personnel pool has been legally operational since November 1988.

Regarding financial policies, the authorities see the strengthening of the budgetary situation as a key element of their adjustment effort. To that end, and as can be seen in Table 7 of the staff report, far-reaching measures of tax reform are being implemented and others are envisaged in the near future, to enhance revenue. On the expenditure side, efforts are also being made to contain the wage bill and other expenses at a level compatible with available resources, although the already low level of spending on material and services is seriously affecting the quality of government services. In the same vein, steps have been taken to monitor closely some categories of expenditures in order to avoid the re-emergence of extrabudgetary outlays. The authorities are of the view that these fiscal measures, combined with the ongoing structural policies, will contribute to reducing gradually the internal and external imbalances.

The authorities recognize that they still have much to achieve in restoring internal and external financial equilibrium and in putting the economy on a sustainable growth path. They are therefore committed to pursuing their adjustment efforts with the assistance of the international financial community, particularly the Fund and the World Bank. They wish to stress that, since the economy is beset mainly by structural rigidities that require long-lasting solutions with adequate resources, they hope that the necessary support will be forthcoming from donors and creditors to facilitate the adjustment process.

Extending his remarks, Mr. Obame said that the authorities wished to emphasize that, despite the delay in the Board's consideration of their request for a second structural adjustment arrangement--owing mainly to some internal administrative and legal procedures for adopting certain measures and to the several late payments made to the Fund--they had been steadily implementing the program that had started in July of the current year. The most recent information indicated that fiscal revenues had fallen short of the performance targets as a result of unforeseen developments beyond the authorities' control. In any event, the authorities had taken necessary steps to prevent any slippages on the expenditure side of the fiscal budget. The staff mission that was expected to visit Bangui shortly would provide an opportunity to reassess the fiscal revenue outturn and to work with the authorities on additional fiscal measures that might be necessary to enhance performance, particularly in the 1989 fiscal budget. The most recent information confirmed that the authorities were continuing to make remarkable efforts at structural reform. He suggested that the staff representative from the World Bank comment on that important aspect of the adjustment process in the Central African Republic.

Mr. Serre made the following statement:

> Despite some progress made by the authorities in the recent past, the Central African Republic still faces serious structural and financial problems; the economy remains vulnerable to external shocks, and the fiscal budget and external deficits are expected to remain large and the debt burden heavy. Consequently, the situation requires stronger adjustment measures and, more than anything else, the authorities' deep determination in implementing such measures.
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> The staff paper makes it clear that much work is still required to achieve sustainable growth in sound economic conditions. In this respect, it is a deep cause for concern that a large part of the reforms designed previously are still not well on track. Therefore, I support the emphasis that the authorities' adjustment strategy has put on both structural and public financial policies. With respect to structural policies, I welcome the measures aimed at reorganizing the Ministry of Rural Development, along with the reforms of the cotton, coffee, foodcrop, forestry, and livestock sectors. It is of the utmost importance to upgrade the whole agricultural sector, as its growth potential remains significant. As for the public enterprise sector, the reform seems to be well on track. However, I hope that the ongoing studies will be completed quickly and that the conclusions will be translated into operational decisions.
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> The authorities' initiative to create an environment conducive to increasing the share of private investment in GDP is welcome, particularly the creation of the promotional agency for small and medium-size enterprises.
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> Taking into account the regrettable slippages that have occurred recently in public financial policies, I stress that it is of paramount importance for the successful outcome of the program that the fiscal sector recover. It is necessary for the authorities to become more stringent in monitoring budgetary policy. To compensate for the decrease in fiscal revenue, the authorities should implement fully the measures contained in the supplementary budget adopted in July. In particular, the fight against fraud, the tax reform, and the reduction in the size of the civil service must be pursued rigorously and with substantial determination to avoid further slippages.

It is of the utmost importance for the authorities to resume discharging their financial obligations to the Fund in order to enhance confidence in their relationship with the international financial community, thereby allowing timely disbursement of external financing.

I agree with the assessment of the policy framework paper that the problems of the C.A.R. economy are structural in nature, and thus can only be solved in a medium- to long-term framework. I hope that the authorities will be committed resolutely to pursuing their adjustment efforts, and I support the proposed decisions.

Mr. Templeman made the following statement:

It was quite appropriate for management to postpone consideration of the Central African Republic's Article IV consultation and its request for a second structural adjustment arrangement from December 5, in view of the questions that have been raised about the viability of the program. In fact, my chair has approached the proposed program under the second structural adjustment arrangement with some uneasiness, in view of the quite poor performance under the stand-by arrangement and first annual structural adjustment arrangement. Not only were some benchmarks missed, principally with respect to external arrears, but also, several important macroeconomic targets were not achieved. Admittedly, there were some unfavorable exogenous factors at work, especially the sharp drop in the terms of trade. That development also had an adverse effect on tax revenues. Still, fiscal performance has been chronically weak.

It is regrettable that the program year for the second structural adjustment arrangement began more than five months before Board consideration of the program. Since then, I understand that the prior actions required, as cited on page 38 of the staff paper, have been taken. But, a number of structural reform measures on the timetable under the second annual structural adjustment arrangement, shown on pages 33-37 of the staff paper, which were to have been taken by now seem to have been only partially completed. In addition, the new information that revenue will again fall substantially short of projections--adding to the financing need--raises questions about whether the Board should approve the program under these circumstances.

Certainly, some progress has been made over the past year or so in establishing an appropriate array of pricing incentives, in creating a more favorable macroeconomic environment, and in bringing about some structural and institutional reforms. Decontrol of some prices in June 1988 and the planned completion of decontrol by next March are important. The positive real interest rates are another favorable pricing factor, although the appreciation of the CFA franc seems to be sending wrong signals about the price of scarce foreign exchange. In the macroeconomic area, the low rate of growth of monetary aggregates and low, or even negative, inflation rate would normally be viewed as favorable factors. However, to the extent that they reflect weak demand and weak growth, they are symptoms of underlying problems. In the key fiscal area, there clearly remain serious problems. The record with respect to structural reforms is more favorable, especially concerning trade liberalization and agricultural and public enterprise reforms.

Appropriately, fiscal policy measures are described by the staff as the "main instrument" for reaching the aims of the program. However, the target reduction of only 0.8 percentage point in the ratio of the fiscal deficit--excluding official transfers--to GDP does not seem very ambitious, particularly since the entire reduction is to come on the revenue side of the fiscal budget, where performance has been chronically weak. And the most recent data suggest that even this reduction will not be achieved.

I welcome structural reforms in the fiscal field, such as tax reform, public enterprise restructuring, the intent to reduce the number of civil servants by 2,000, and the commitment to avoid both extrabudgetary expenditures and the accumulation of any new arrears. Especially important is the need for prompt implementation of tax reform measures to expand the domestic revenue base and to make the Central African Republic less vulnerable to unexpected world trade developments. In this connection, the projection of no increase over the medium term in the ratio of fiscal revenues to GDP is puzzling.

On the expenditure side of the fiscal accounts, the cost of severance pay from the reduction in overstaffing and the continued stabilization of the cotton and coffee sectors will contribute to an actual increase this year in the ratio of government spending to GDP. Rising severance pay may be inevitable; but, with respect to subsidies, the staff should explain why it describes the continuation of such expenditure as "indispensable." Over a relatively short period of time, there may be a socioeconomic case for assigning subsidies such importance; but it is not clear why subsidization should be open ended, particularly in view of the clear need to diversify the economy.

Continued progress in reforming the public enterprises and in encouraging private enterprise will be extremely important, both for achieving a higher growth rate and for diversifying exports. The role of the World Bank will be important in the first area, as will be the regular adjustments of public enterprise prices in line with operating costs.

Balance of payments performance has been disappointing. While worsened terms of trade have not helped in this respect, levels of both export and import volume have been weak. The current real effective exchange rate of the CFA franc raises serious questions about prospects for export growth and diversification, and about the outlook for achieving a viable balance of payments at acceptable rates of real growth. Certainly, exchange rate stability and the existence of a regional central bank provide a useful discipline in avoiding the pattern of monetary expansion, inflation, and currency depreciation that have sometimes plagued other countries. Nevertheless, the burden placed on fiscal policy to restrict demand--and possibly growth--in defense of the exchange rate, seems rather heavy. This factor might also help to explain the Central African Republic's prolonged use of Fund credit. Moreover, the prospects for continued trade liberalization may be undermined by doubts about international competitiveness. I note that Executive Directors at the World Bank, in discussing the new policy framework paper, indicated that, "IMF and Bank staff must make additional efforts at analyzing and discussing the exchange rate issues and/or alternative measures to stimulate growth and enhance competitiveness with the appropriate regional authorities." The staff could usefully comment on this matter.

In assessing the medium-term outlook for balance of payments viability, I welcome the indication that there might not be a financing gap after 1991 and that the authorities will try to avoid debt rescheduling after 1988-89. However, such an outcome will apparently take place in the context of low rates of economic growth, slow growth of foreign trade, and no decline in the ratio of external debt to GDP. In fact, the staff paper acknowledges that the Central African Republic faces "a very difficult medium-term structural and financial outlook and protracted balance of payments disequilibria." All these factors underline the need for very firm implementation of the program under the second structural adjustment arrangement and, if anything, of an even stronger effort beyond.

The Board cannot ignore the fact that the Central African Republic has a record of slow repayment to the Fund. The medium-term projections show a debt service ratio to the Fund alone rising to a peak of 6.1 percent of exports in 1989. Therefore, I welcome the arrangements that the authorities have made to enable the country to remain current in its financial obligations to the Fund during the program period.

I have listened with interest to the explanations given by the staff and by Mr. Obame on the shortcomings that have already appeared in the program and its financing, and of the circumstances behind such difficulties. My authorities are well aware that progress has been made under the program, and of the positive aspects of the adjustment and reform actions that are to be taken during the remainder of the program. I am somewhat reassured by the statements made concerning the focus on means of avoiding and compensating for revenue shortfalls in the future, which will be examined by Bank and Fund missions in January, and by the indication that heroic Paris Club debt relief is not anticipated to fill the larger financing gap. On this basis, but only with serious reservations, especially about an adverse precedent that could be set, I support the request for a second structural adjustment arrangement.

The Chairman said that Directors would carefully note the reservations of Mr. Templeman.

Mr. Kiriwat made the following statement:

I am in broad agreement with the staff appraisal and can therefore support the proposed decisions.

The authorities are to be commended for their successful implementation of major structural measures under the first structural adjustment arrangement, as well as under the World Bank's structural adjustment loan, despite very difficult external developments. It is particularly gratifying that significant progress has been achieved in removing price controls, liberalizing the trade regime, restructuring parastatals, and reforming the agricultural sector. These measures, together with the improvement in rural transportation, have contributed to increases in the food supply and to a sharp decline in general prices during 1987.

However, the economy remains fragile, and most macroeconomic targets under the first structural adjustment arrangement have not been met. It is therefore imperative for the authorities to persevere with their long-term adjustment efforts and to prevent a recurrence of slippages and delays in policy implementation. Under the Central African Republic's circumstances, it is also important that these efforts be accompanied by adequate and timely concessional external financing. The experience during the first annual arrangement shows the substantial unfavorable impact, particularly on the growth and fiscal deficit targets, of the delay in obtaining full funding of the investment program from donors. In this respect, I agree with the staff that an adequate response from donors will be crucial for the achievement of the program's objectives.

I note that the growth target has been revised downward, reflecting a continued difficult external environment and the scaling down of public investment expenditures. While I agree that the target should be attainable in general, I wonder whether the growth target for 1989--about the same as the population growth rate--is not too low in view of the continued decline in per capita income over the past three years. At this stage of structural reform, an increase in per capita income would be crucial for the sustainability of the adjustment program. The staff should comment on the possibility of the Central African Republic obtaining more grants or concessional flows to enable it to achieve a faster growth rate in the coming year.

I agree that significant reduction of the fiscal deficit will contribute positively to the overall performance of the economy. However, as pointed out in the staff paper, this is the area where progress seems to be very slow, and where there have been repeated failures to meet program targets during the past eight years. While I realize the dominant role played by various external factors, with the benefit of hindsight, the repeated failures might also be due to the staff setting overoptimistic performance targets without properly taking into account the particular characteristics of the Central African Republic, including its administrative capacity to implement various adjustment programs. Under the circumstances, I welcome the authorities' commitment to resume the path of fiscal adjustment, especially through significant reduction of the wage bill and full implementation of tax reform, including the reinforcement of tax administration.

Efforts should continue to be directed toward improving external competitiveness and enlarging the export base. In this respect, I agree with the staff that, in the absence of a flexible exchange rate policy, further structural and liberalization measures will be required to strengthen the private sector and to improve its efficiency. Nevertheless, the authorities should study further the appropriateness of their exchange rate policy within a regional context.

Mr. Enoch said that the staff papers were interesting and helpful, but obviously reflected the fact that the bulk of analysis had been carried out in the early part of the current year. Even though the difficulties that had created such a time lag before the Board discussion were understandable, he was somewhat uneasy about analyzing a country in which the situation was bound to have changed in a number of respects from that described in the staff papers. The updated information given by Mr. Obame on the recent implementation of policy measures and by the staff on performance in 1988 were welcome.

It was clear from the staff papers that the authorities had shown commendable commitment in 1987 in implementing the structural measures envisaged under their adjustment program, Mr. Enoch commented. The list of measures described in the staff papers was impressive. In particular, the substantial progress made in liberalizing prices, abolishing restrictions on the marketing of local production, and improving feeder roads was welcome. Indeed, those reforms already appeared to have had some sort of impact on increasing agricultural output.

Nevertheless, as the staff paper made clear, overall performance in 1987 had been mixed and, indeed, somewhat below expectations, Mr. Enoch noted. Thus, despite the authorities' diligent implementation of structural measures in 1987, there had been a considerable slippage in the implementation of financial policies. The latter was due partly to shortfalls in fiscal revenue and partly to incomplete implementation of planned expenditure restraints. In particular, the savings that should have resulted from the "three-for-one" salary savings rule in the civil service had been offset by promotions, extrabudgetary expenditure, and the provision of fringe benefits. The authorities should not permit recurrence of those slippages and should ensure the full implementation of the envisaged measures under the current financial program. In that connection, the program for further cuts in the civil service seemed to be of central importance.

The slippage in implementing financial policies was obviously not the only reason for mixed performance of the economy, Mr. Enoch continued. The Central African Republic suffered from a further serious deterioration in its terms of trade in 1987, with the prices of nearly all of its major export crops falling markedly. In addition, some of the performance shortfalls could be related to the highly fragile and perilous initial position on which the reforms had necessarily been grafted. For instance, domestic savings had been negligible and sometimes even negative, and international reserves had been low. As a result, the country could not obtain anything near the full benefits possible from the good coffee crop in 1987, as the authorities did not have sufficient budgetary resources to permit full and timely purchase of the crop.

In addition, the limited administrative capacity of the Central African Republic had clearly set additional constraints, Mr. Enoch pointed out. The failure to provide satisfactory documentation to ensure full World Bank credit flows, which had led to significant fiscal revenue shortfalls, was a clear example. Given the ambitious range of structural and financial reforms envisaged under the proposed program, the limited administrative resources would have to be used as effectively as possible.

The other factor that had undoubtedly contributed to the relatively disappointing performance in 1987 had been the exchange rate, Mr. Enoch noted. The staff paper suggested that the currency had appreciated in real effective terms by about 10 percent since 1985. Given the deteriorating external environment facing the country, that movement had inevitably caused major difficulties. The failure of the structural reforms to have a significant impact on economic performance beyond the agricultural sector thus far was attributed by the staff paper largely to the lack of activity in the economy, activity that clearly could be stimulated by a more appropriate exchange rate.

Looking to the future, the exchange rate was likely to continue to impose serious costs on the country, Mr. Enoch considered. There was no prospect for any significant progress toward establishing medium-term economic viability without continued large concessional capital inflows. The overall growth rate was projected to rise only very slowly from its current rate of about 2 percent a year, which was below the rate of growth of the population; and even by 1992, per capita income was projected to be below that reached at the end of 1985. Not only was the lack of activity in the economy likely to continue to jeopardize the success of the structural reforms, it would also make more difficult the implementation of the financial reforms envisaged under the program. He noted that in their understandable concern to protect the incomes of small farmers, the authorities had not reduced the producer prices of some major export crops, and thus had to increase the subsidies to marketing boards. An exchange rate adjustment would have permitted producer prices in local currency to have been maintained while reducing the need for fiscal subsidies.

As his chair had noted before, each country obviously had the right to choose its own exchange rate system, Mr. Enoch stated. However, from the point of view of the Fund, it was a matter of concern when an adjustment program had to be designed that might well impose a higher degree of austerity and might have less impact on stimulating growth than would be the case with an adjustment of the exchange rate included.

The important point had been made on page 40 of the staff paper that arrangements had been made to enable the Central African Republic to remain current in its payments to the Fund, Mr. Enoch remarked. The staff could usefully comment on those arrangements. With the updated information and assurances given by the staff, he endorsed the authorities' efforts at structural and financial reform and supported the proposed decisions, even though he foresaw a continued difficult economic future for the Central African Republic.

Mr. Marino said that he was encouraged by the main thrust of the policies implemented by the authorities under the first annual structural adjustment arrangement, particularly those directed at correcting the institutional rigidities in the economy. Certainly, the progress made in liberalizing prices and the trade regime, containing the wage bill, revamping the parastatal sector, making more efficient the production and marketing of agricultural products, and promoting wood exports would be significant building blocks on which to base the development process.

The economic and financial policies that the authorities would adopt under the second annual structural adjustment arrangement seemed to be consistent with the attainment of the growth rate, inflation rate, and balance of payments objectives, Mr. Marino stated. He shared the same concerns expressed by some Directors with respect to the growth objective of 2.5 percent a year through 1991, and hoped to see efforts directed at revising it upward in the future. Moreover, he agreed with the staff that the balance of payments projections were fragile; the vulnerability of the Central African Republic to external shocks, from climatic changes and those relating to the prices of the country's export commodities in world markets, remained unsolved. The program targets should therefore be reviewed with flexibility, as the attainment of internal and external balance in the economy would depend greatly on the vagaries of world commodity prices and on luck with respect to weather conditions. The authorities should be patient in waiting to reap the benefits of their adjustment efforts and should persevere with the structural reforms.

He commended the authorities for their efforts to reduce the wage bill and to strengthen public finances in general, Mr. Marino remarked. The transition costs associated with that effort would be ameliorated to the extent that the private sector responded vigorously to the new economic environment. In that connection, it would be very important that the public investment program contemplated for the next few years was complementary to private sector undertakings, and therefore that great care should be given to project selection in the public sector to ensure that it carried an adequate social rate of return.

The donor community should support the Central African Republic's adjustment effort with generous amounts of fresh funding, and the authorities should continue fostering an environment conducive to growth, Mr. Marino added. He endorsed the proposed decision.

Mr. Archibong made the following statement:

> The staff has documented the difficult economic and financial situation confronting the Central African Republic. Structural impediments, unfavorable external developments, and inadequate fiscal policies are, in large measure, the underlying causes of the economy's problems. However, since the early 1980s, the authorities have made commendable efforts to adjust their economy with the support of a number of stand-by arrangements. Moreover, the three-year structural adjustment arrangement that was initiated in 1987 must be seen as representing the authorities' continued genuine search for a solution to the problems of the domestic and external imbalances and of insufficient growth.
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> Unfortunately, despite the implementation of the program under the first structural adjustment arrangement, economic activity has remained depressed. This implies probably that the authorities need to undertake a long-term effort to establish sustained growth. Given that the policy framework paper does not appear to provide a medium-term scenario on attaining

adequate growth, there may be some concern about the need to accelerate the pace of economic activity over time to contain, inter alia, the growing unemployment problem.

Performance under the first structural adjustment arrangement seems to have been largely satisfactory in view of the country's economic environment. Even though lack of budgetary resources impeded any improvement in fiscal performance, success has been achieved in implementing structural measures, such as the liberalization of the pricing and trade regimes and of the public enterprise sector. The flexible producer price system that provides a minimum guaranteed income, particularly for cotton and coffee farmers, could stimulate the production and export of these primary commodities. However, I hope that the coffee stabilization fund, which is to be managed jointly by the Government and private exporters, will seek principally to stabilize the price of coffee and not the income of farmers. If the authorities' focus is more on the stabilization of coffee exporters' income and the accumulation of revenue for the Government--especially during periods of buoyant world market prices--the stabilization fund might be counterproductive, as it could encourage the smuggling of coffee out of the Central African Republic by middlemen in an effort to benefit from higher world market prices.

I welcome the proposed study of the customs tariff structure. The reported persistent fraud in the Customs Department calls for urgent action as customs revenues are of substantial importance. A comprehensive review and improvement of customs operations should seek to eliminate fraud and to enhance revenue collection. On the expenditure side of the fiscal budget, although labor retrenchment in the public service would reduce pressure on the budget, such a salutary effect might not occur in the short run given that the Government would require a considerable amount of money to pay retrenchment benefits to those affected.

As a member of the Bank of Central African States (BEAC), with a common currency, the Central African Republic has limited room for maneuver in the area of monetary policy. And as independent exchange rate action--which might be necessary to stimulate growth and to enhance competitiveness--is difficult to effect, the authorities must place greater reliance on full implementation of other measures under the program. Nonetheless, the staff should keep up the discussion of exchange rate issues with other members of the BEAC.

The authorities' comprehensive reform program for the period 1988/89-1990/91, supported by the second structural adjustment arrangement, embodies measures that could be adequate for achieving the declared medium-term objectives, particularly those relating to the domestic and external imbalances. It is a strategy based on prudent demand management, strengthening of the government finances, and encouraging the private sector to play a larger role in productive activities through the implementation of appropriate structural policies. The strategy could succeed if resources are made available on a timely basis.

In this connection, it is necessary to note that the failure to implement fully a number of previous Fund programs was due largely to inadequate and often untimely external funding, not to lack of commitment by the authorities. While fiscal performance was weak, I agree with the staff that an adequate response from donors to meet the projected financing requirements will be an important factor in the achievement of program objectives.

I fully endorse the authorities' program of structural adjustment and support the proposed decision.

Mr. Wenzel commended the authorities for their overall successful implementation of a number of important structural reforms, especially the further liberalization of the price and trade regime, the reforms in the agricultural sector, and the continued privatization of public enterprises. The progress made in structural reform was most welcome, although it was clear that before such reforms could be used to their full effect, they would have to be complemented by appropriate macroeconomic policies, and be consistent and comprehensive.

In that context, it had been disappointing to note the lack of progress in a number of areas, Mr. Wenzel observed. For instance, the budget outcome for 1987, and most likely for 1988, had fallen considerably short of the program target. Even though adverse external developments, at least in 1987, had surely contributed significantly to a shortfall in fiscal revenues, one could identify a number of contributing factors within the authorities' sphere of influence that had been emerging for some time. Specifically, the worrisome weaknesses of the Government in collecting tax revenues, as well as what appeared to be a postponement of the envisaged tax reform, were essentially responsible for the disappointing fiscal revenue performance.

He certainly welcomed the authorities' intention to strengthen fiscal revenues and the assurances given by Mr. Obame in that respect, Mr. Wenzel continued. As the prompt implementation of the tax reform would be a crucial element to increasing such revenues, it was worrisome to note that the policy framework paper gave only a vague indication that tax reform measures were to be implemented in the period 1988-90; more ambitious and more specific deadlines would have been preferable. With respect to fiscal expenditure, the planned correction of public sector overstaffing was welcome. Fiscal performance and the future performance of the private sector would benefit even more with the Government's intended withdrawal from the public enterprise sector.

The appreciation of the currency in real effective terms was clearly not helpful to the authorities' adjustment efforts, Mr. Wenzel judged. Given the prevailing institutional arrangements, however, exchange rate policy was not an available policy instrument. He noted from paragraph 3 of the Chairman's opening statement that efforts were under way to support a regional approach to the problem of the exchange rate. The staff or the World Bank representative could usefully comment on the point. Meanwhile, it appeared that further progress in price and cost stabilization was the only feasible alternative to correcting the overvalued currency. The authorities should thus continue vigorously with their efforts to reduce the inflation rate through a tight domestic credit policy and to exploit fully the room for maneuver given by the institutional arrangements for interest rate policy. It went without saying that adequate interest rate levels were essential for the mobilization of savings and the strengthening of investment, which were obviously crucial for progress on the external front.

The authorities would have to make every effort to adhere fully to the program measures and to stand ready to take additional adjustment measures if necessary, Mr. Wenzel considered. In that respect, the fiscal area was clearly the "cornerstone" of the program, as the staff put it. The staff was correct in stating that the attainment of the fiscal targets would require substantial determination. It would be most regrettable if slippages in implementing fiscal measures occurred, since they would be detrimental to the credibility of the authorities' policies, and would certainly not be without adverse repercussions on the willingness of the international financial community to support the adjustment effort.

He informed the Board that his German authorities were in the process of extending debt relief on outstanding official development assistance loans and that new external assistance, as in the past, would continue to be provided in the form of grants.

The staff representative from the African Department said that the staff had been relatively cautious in projecting fiscal revenues, as tax collection had been a shortcoming of the authorities over the past few years. The slow increase in the ratio of fiscal revenues to GDP was largely attributable to the fact that a major proportion of revenues came from the agricultural sector, in which many subsistence farmers did not pay taxes. In that connection, agricultural sector subsidies were "indispensable" in view of the cost-cutting measures that the authorities had taken in, for instance, the cotton agency, where staffing had been reduced by more than half, fleets of trucks had been sold, and gin mills had been closed, and in the agricultural stabilization fund, where staffing had also been cut. It was necessary to stabilize producer prices given inherent costs and the level of world market prices. Nonetheless, the staff projected that price supports would have to decrease over the long run. Meanwhile, the authorities would try to increase competitiveness in the areas of livestock and foodcrop production to mitigate the effects of continued subsidies, particularly for cotton and coffee.

The Chairman inquired whether the staff maintained in an unqualified manner that the subsidies were indispensable.

The staff representative from the African Department responded that, in view of cost-cutting actions that had been taken, the subsidies were necessary on a temporary basis. Continuing his remarks, he noted that regional consideration had been given to adopting tighter monetary and fiscal policies as an alternative approach to exchange rate policy. With respect to fiscal policy, civil service retrenchment was a major tool for the authorities as were the cost-cutting measures that had been mentioned. To increase the competitiveness of domestic industry, the Central African Economic and Customs Union was implementing the recommendations of a study on complementary taxation. There was no clear-cut timetable for implementation of the tax reform, which was an ongoing process that would yield results gradually. The tax reform was thus difficult to quantify, although Table 7 of the staff report did show the schedule of studies and actions that had been taken and that were envisaged throughout the program period.

The staff had been quite cautious in projecting growth in its medium-term scenario, given that the investment program had been scaled down substantially and that additional quality projects were necessary to ensure a more solid base for further growth over the medium term, the staff representative explained. The authorities had agreed with the Fund and the Bank to review the investment program periodically as more worthwhile projects became available. The staff expected to review the entire macroeconomic framework in January 1989, under which the possibility of including new projects in the investment program had not been excluded. The growth rate would be affected accordingly. The authorities had informed the staff that additional financing for investment would become available with the promises of Switzerland and the European Communities to increase aid.

The authorities had recently been current in meeting their financial obligations to the Fund, and they did not want their past repeated delays in settling with the Fund to recur, as such deferrals had hampered their ability to mobilize resources on a timely basis, the staff representative stated. The authorities had therefore made an internal arrangement with the regional central bank, the Banque des Etats de l'Afrique Centrale, for the counterpart funds of the structural adjustment arrangement to be placed in a separate account, to be used exclusively for drawings and repurchases during the program period. The structural adjustment arrangement resources would not be available for other budgetary purposes, but would remain exclusively for the adjustment program.

The staff representative from the World Bank said that the main structural components of the program were agricultural and parastatal sector reform, investment programming, and industrial and liberalization policy. Even so, he would first update Directors on the civil service reform, which aimed at putting into place a productive civil service while at the same time reducing the wage bill that took too large a share of budgetary resources. Even though the short-term objective of reducing civil service staff would attract most attention, the long-term improvement in staff, institutional quality, management tools, and incentives would play a crucial role in the reform. That was one of the main objectives of a proposed economic management project scheduled for consideration by the Executive Directors of the Bank on December 13. To prepare and implement a thorough reform, diagnostic studies of the staffing needs of the various ministries had to be prepared, staff to be retained had to be selected, and a scheme had to be put in place for compensating departing civil servants and for assisting them to find alternative employment. Each of those steps had been undertaken, but with some delays. By the end of 1988, the staffing plans for six ministries would have been completed, while two ministries were currently being reorganized. It was expected that by mid-1989, all staffing plans would have been completed and implemented. It was still the authorities' estimate that the full implementation of the program would reduce the number of civil servants by about 2,000, or by about 10 percent of the civil service.

With respect to agriculture, the authorities were making substantial progress in increasing the role of the private sector in the coffee subsector, the Bank staff representative continued. A new coffee price stabilization fund (CAISTAB) had been created in May 1988 with important private sector participation in its management. A study to prepare a new flexible producer price system was expected to start in January 1989; and in a first step toward privatization of the commercial activities of the cooperatives, CAISTAB had cleared the arrears of the cooperatives to suppliers and the banking system.

In the cotton subsector, all of the arrears incurred under the 1985/86 and 1986/87 campaigns to reduce acreage under cultivation and to cut back extension services had been cleared, through either rescheduling or cash payment, and an important portion of the 1987/88 subsidies had been paid, the Bank staff representative remarked. The World Bank continued to provide support to the restructuring of the cotton subsector through the ongoing Cotton Sector Adjustment Credits.

With respect to foodcrops, livestock, and forestry, the implementation of the structural measures was on track, the Bank staff representative added. Diversification was an important element of the Government's structural program and various studies had been finalized already, while others were being prepared. Especially important was the diversification of agricultural production in the cotton subsector.

The reform of the Ministry of Agriculture was ongoing, the Bank staff representative commented. The staff to be retained in the Ministry were being chosen, while those in surplus would be transferred to the personnel pool. The authorities were in the process of formulating a national extension and research strategy with the help of foreign technical assistance, which was expected to be completed before end-November 1989.

The authorities were currently preparing the three-year rolling public investment program for the period 1989-91, as well as the capital budget for 1989, the Bank staff representative pointed out. Those could be examined by the Bank in the course of its missions during the coming calendar year for monitoring the structural adjustment loan.

The industrial and liberalization program was basically on track, although there had been some delays in the implementation of the reorganization of the Ministry of Commerce, the Bank staff representative noted. However, the staff of the Ministry was being selected at present.

The reform of the parastatal sector entailed a number of liquidations and privatizations that had been achieved already, other privatizations and enterprise restructuring under negotiation, as well as further important structural reforms, the Bank staff representative explained. With respect to the measures included under the second structural adjustment arrangement, the range of activities under CAISTAB had been defined clearly; and the financial and management audit of CAISTAB--to define recommended limits to its commercial activities--was to start in January. In a first step toward rehabilitating the National Electricity Company (ENERCA), electricity tariffs would be increased significantly in January 1989, and would be kept under review thereafter. Rehabilitation plans for three main utilities and "contrat-plans" for ENERCA and the National Water Company (SNE) would be prepared shortly. All of those documents would be finalized by March 1989. The study on the legal and institutional framework had been completed and was being examined by the authorities as well as by the staff of the Fund and the Bank. After consultation among the parties, the study's recommendations would be implemented during the course of 1989.

Mr. Obame said that under its current obligations to the Banque des Etats de l'Afrique Centrale (BEAC), the Central African Republic could not act alone on the exchange rate. Even though some discussion was going on among members of the Monetary Union of adjusting exchange rates, no immediate action was foreseen.

The adjustment process in the Central African Republic could not succeed without the provision of adequate and timely external financial flows, Mr. Obame stated. The authorities were implementing a difficult adjustment program, which had a very moderate growth target, and thus increased external financing would be necessary to promote higher per capita growth. In that connection, he thanked Mr. Wenzel for the German Government's provision of debt relief. He hoped that other creditors would be as sensitive to the Central African Republic's difficult situation.

The Chairman made the following summing up:

Executive Directors welcomed the implementation by the Central African Republic of a number of structural reforms, notably in the agricultural sector, the streamlining of public enterprises, and the authorities' effort to contain current spending, partly through civil service reform. They were greatly concerned, however, over the continued serious weaknesses in the public finances, which had already led to a change in the program targets. Directors therefore stressed the need for forceful remedial action.

Directors welcomed the measures taken to achieve liberalization of prices and of the trade regime through the lifting of price controls and the abolition of import licensing and quotas; to streamline the cotton and coffee sector, essentially through cost-cutting measures; and to rehabilitate public enterprises through divestiture and restructuring. Directors encouraged the authorities forcefully to pursue, with World Bank assistance, the ongoing reforms in these areas.

Given the Central African Republic's exchange rate arrangements, Directors expressed deep concern over the slippages in budget performance in 1987, particularly the large shortfalls in tax revenue, the re-emergence of extrabudgetary expenditure and deviations in wage developments from policy intents. They underscored the need for a tight fiscal policy stance, particularly as revenue performance had thus far fallen well short of expectations.

Directors agreed, therefore, that there was an urgent need to widen the customs and tax base and to strengthen revenue collection mechanisms. They welcomed the technical assistance that the Fund and others would make available to this end. On the expenditure side, they welcomed the decision to reduce the size of the civil service during 1988/89, with a view to enhancing the contribution of budget savings to the financing of the public investment program. In this context, Directors noted the authorities' commitment to reviewing the investment budget in order to retain only those priority projects that were conducive to growth.

Directors stressed that effective and quick implementation, including careful monitoring, of the above-mentioned measures and related structural policies would be crucial to the success of the authorities' medium-term adjustment program and the achievement of their objectives for growth and the balance of payments. The disappointing growth performance in 1987/88 was at least partly the result of policy slippages, exacerbated by the need to offset the adverse effects of an appreciating currency on competitiveness. And, Directors voiced disappointment regarding the rather low growth profile that was contemplated in the medium-term outlook.

On the external side, Directors welcomed the authorities' decision to make appropriate arrangements to remain current with the Fund. They expressed great concern, however, over the prospective external financing gaps and the substantial dependence of the Central African Republic on continued large-scale conditional assistance from creditors and donors, and on debt relief. While sizable external support was justified by circumstances, the authorities' adjustment efforts would have to be much expanded and deepened if sustainable growth and external viability were to be within reach. Directors welcomed the indications given that Germany was in the process of extending debt relief on outstanding official development assistance loans.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision in concluding the 1988 Article XIV consultation with the Central African Republic, in the light of the 1988 Article IV consultation with the Central African Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Central African Republic maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, with the exception of the limits on foreign exchange availability for tourist and business travel, which the Central African Republic maintains in accordance with Article XIV, Section 2.

Decision No. 9040-(88/179), adopted
December 12, 1988

Structural Adjustment Facility - Second Annual Arrangement

1. The Government of the Central African Republic has requested the second annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress in implementing the policies of the program supported by the first annual arrangement and notes the updated policy framework paper (EBD/88/320).

3. The Fund approves the arrangement set forth in EBS/88/228, Supplement 2.

Decision No. 9041-(88/179), adopted
December 12, 1988

3. SUDAN - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Sudan's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund, effective February 3, 1986 (EBS/88/249, 12/6/88).

Mr. El Kogali made the following statement:

As Directors have been informed by the staff, Sudan has implemented all the measures relating to fiscal year 1987/88 that were incorporated in its "Program of Action" formulated in consultation with Fund staff. The deviations from the performance targets, indicated in the staff paper, were, therefore, more a reflection of exogenous factors, like shortfalls in aid, civil disturbances in the South, and drought conditions, than lack of implementation of agreed policies.

Similarly, the authorities' ability to continue to adopt and implement, on time, a strong and comprehensive adjustment program in 1988/89 was influenced by the staff's insistence on exchange rate and price actions that were not justified fully on economic grounds, and would, if implemented, have been destabilizing and self-defeating given the lack of political consensus. These difficulties were compounded by the devastating floods that hit Sudan in August/September 1988. Apart from the interruption of the implementation of the adjustment program, the floods made about 2 million people homeless and caused massive damage to agricultural production, property, and infrastructure. Furthermore, the disaster had adverse implications for government financing. The need to provide relief operations necessitated additional expenditure beyond what was budgeted, and revenue collection was hampered by the adverse impact of the crisis on both taxpayers' earnings and the tax administration's operations.

However, Sudan has continued to implement strong measures. The 1988/89 budget representing the first phase of the four-year

Recovery and Development Program contained a wide range of policies. Structural measures in the budget included: liberalization of price and profit controls; deregulation of the export trade by the simplification and streamlining of export registration procedures, elimination of the export licensing requirement, cancellation of minimum export prices, and the removal of the government monopoly on the export of oilseeds; setting of producer prices in line with international prices and the acceleration of cost recovery of irrigation services, including land and water charges in irrigated schemes; reform of the parastatal sector, including the selling to the public of government-owned commercial banks and hotels, liquidation of nonviable enterprises, such as the Blue and White Nile Schemes, and rationalization of the remaining entities, with assistance from the World Bank.

Fiscal measures to contain expenditure and to increase revenue included: assessment of corporate tax on a current-year basis, review of property tax assessment, conversion of specific taxes to an ad valorem basis, and adjustment of utility rates to reflect increases in costs. Suggestions for new taxes under consideration include a 5 percent minimum flat rate income tax on small businesses, a wealth tax, and the reinstatement of a national development tax. Moreover, expenditure control measures will be strengthened, including reinstitution of the flash reporting system, and tight monitoring to prevent the re-emergence of extrabudgetary expenditure.

In a further demonstration of their commitment to adjustment, the authorities, following immediate relief efforts, and despite the difficult situation, intensified their adjustment effort by implementing new measures, including bold reform of the exchange rate system and additional measures to strengthen the fiscal position. In October 1988, a two-tier exchange rate system was introduced with arrangements that will make most exports competitive and provide substantial incentives for remittances. The authorities view the system as a pragmatic approach to the socially and politically sensitive issue of exchange rate reform, and they intend to manage this interim arrangement in a flexible manner through gradually shifting commodities to the commercial bank market, with the ultimate objective of establishing a unified exchange rate.

Based on the fiscal budget review, proposals have been submitted to the Cabinet for additional measures to compensate for the expenditure overruns and revenue shortfalls that resulted from the disastrous flood. Steps being taken to reduce expenditure include a change in the allocative formula for central and regional spending units--to reduce expenditure allocations by about 16 percent--tighter scrutiny of the payroll, and invoice control. The Cabinet is also considering certain measures to increase the excise and import duties on many commodities and raising the prices of some essential and socially sensitive commodities including sugar, gas, and bread, which will help to reduce expenditure and to generate more revenue. In addition, a reconstruction tax is being introduced, and the excise tax on cigarettes will be increased. These new measures are expected to go into effect by January 1, 1989. Despite strong pressures from trade unions, the Government has resisted a general wage increase. While recognizing the continued erosion of civil service employees' salaries and wages, the authorities do not intend to approve general wage increases during the current fiscal budget.

The authorities are willing to move forward and are aware that all the measures described are aimed at laying the groundwork for a comprehensive adjustment program that they intend to launch at the beginning of fiscal year 1989/90. They have asked a staff mission to visit Khartoum in January 1989 to discuss the elements of such a program and the policy areas to be covered. While re-emphasizing their willingness and commitment, the authorities will ask for flexibility and realism on the part of the Fund, to make agreement on a comprehensive and implementable program possible.

The authorities are aware of the arrears problem and would like to reiterate their commitment and willingness to meet their financial obligations to the Fund as soon as the situation allows. They would like to emphasize that the severe shortage of foreign exchange and their inability to secure the needed resources are the main reasons for the continued unfortunate situation. However, it should be stressed that Sudan, on its own, will not be able to clear the arrears. In this context, the authorities welcome the new collaborative approach endorsed by the Interim Committee to help resolve the problem of overdue financial obligations. On their part, they are willing to implement a comprehensive adjustment program in the hope that the international community will assist in mobilizing financial support, which will enable Sudan to implement the adjustment program, clear the arrears, and regularize its financial relations with creditors, including the Fund. To accelerate the process, there should be a parallel move by the Fund on procedures to provide the necessary financial support.

On a personal note, let me add that the Fund, in its staff paper and decisions, should reflect the cooperative spirit of Sudan in handling its relations with the Fund, and the efforts that the authorities are making under most difficult circumstances. A lot remains to be done, but it is also true that the authorities have made, and continue to make, substantial progress. Recognition by the Fund of these efforts will surely encourage the authorities to do more. It is neither in the interest of the Fund nor Sudan to overemphasize negative aspects of the situation, and to overlook actions that are being taken.

Extending his remarks, Mr. El Kogali noted that following the endorsements by the Board and the Interim Committee of the new collaborative approach to resolving the problem of overdue financial obligations to the Fund--involving countries in arrears, creditors, and the Fund--movement to implement that policy had been somewhat slow. It was a known fact that the bulk of arrears were concentrated in four to five countries and that a satisfactory resolution of the problem could be obtained by focusing efforts on those few countries. It was encouraging that efforts had been made recently to assist some countries that had relatively small arrears; he welcomed those efforts most sincerely. Nonetheless, no concrete steps had yet been taken to address the problem of countries with large arrears. For example, he was not aware of any move to form a support group for a country such as Sudan. Sudan was moving toward adopting a comprehensive adjustment program, but its action had not been matched by parallel action of participants on the other side of the collaborative approach. In such a situation, not much progress was likely to be achieved. He recalled Mr. Dallara's earlier suggestion to the same effect and was interested to hear other Directors' comments on the matter.

He strongly supported the view that payments to the Fund should be given priority, Mr. El Kogali pointed out. However, giving such preferred creditor status to the Fund basically assumed that the country so doing had sufficient resources to allocate freely among creditors. However, when the "choice" facing a country was to pay for basic food imports and other amenities to sustain human life, effective freedom of choice with respect to allocating foreign exchange did not exist. In that connection, when the staff reported on actual payments, it should elaborate on their nature to give Directors a more complete picture of the circumstances surrounding such payments. Furthermore, Table 1 of the staff paper did not include the $1 million paid by Sudan on October 1; and the staff had just confirmed that another $1.2 million had been paid on December 9, making Sudan current in the SDR Department. Those were small amounts relative to the size of arrears, but they represented a substantial effort under the exceptionally difficult circumstances that Sudan was facing. They also showed that Sudan accorded priority to making payments to the Fund and thereby indicated the authorities' commitment to resolving the arrears problem.

The Government's recent initiative to seek a peaceful settlement in southern Sudan had been accepted by the rebels, Mr. El Kogali remarked. Hopes were currently running high that the negotiations in progress would result finally in a settlement of the civil disturbances, which would no doubt free substantial resources to enhance progress on the economic front.

The Chairman disagreed with Mr. El Kogali, noting that the new collaborative approach was being pursued actively and was moving ahead, including with respect to the two countries that had the next largest arrears to the Fund. He could not yet report on that matter, but could say that dialogue was developing with those countries and action was being taken.

The staff representative from the Treasurer's Department said that Sudan had paid SDR 0.9 million, or its net SDR charges, and was therefore current in the SDR Department. With that payment, Sudan had paid a total of SDR 1.7 million since the last review, and its total arrears to the Fund were currently SDR 713 million.

Mr. Nimatallah asked Mr. El Kogali why he wanted to speed up the formation of a support group.

Mr. El Kogali said that the Fund had to help countries in arrears to take action on the domestic front; sending messages of regret from the Board every three months was becoming a counterproductive habit. Forming the support group would allow the Chairman to contact Sudan and to tell the authorities that help would be provided if they moved faster on adopting a comprehensive adjustment program. That approach would be more productive than the one used thus far, in that a support group could help create a comprehensive program, instead of vice versa.

Mr. Nimatallah commented that he had expected Mr. El Kogali to have mentioned the matter of financing more than that of the comprehensive program, as the Fund was pursuing the latter with the authorities. He saw substantial merit to looking into the possibility of establishing an escrow account or the like for countries in arrears to the Fund, irrespective of whether or not they had a support group. Funds could be placed in that account by the authorities and by donors on a regular basis, and would, like a support group, assure the authorities and other countries that sufficient funding was available to finance adjustment measures and, with the agreement of all parties concerned, the payment of charges as well. Such an account would alleviate donors' concerns that money would disappear, for instance, into the fiscal budget.

The Chairman asked Mr. El Kogali to describe new developments with respect to the Government's peace initiative.

Mr. El Kogali explained that one of the government parties, in consultation with the Prime Minister, had met and signed a peace accord with the leader of the rebels. After much discussion in Khartoum, the Cabinet had decided to support the agreement unanimously. Recent press reports indicated that the Minister of Foreign Affairs and the Minister of Defense had been scheduled to meet with the rebel leaders to work out the details of the peace agreement before December 31, which was the agreed date for forming a committee to prepare for a comprehensive round table discussion on the accord's details. Owing simply to procedural problems, that meeting had unfortunately not yet taken place.

He had not meant to criticize management's approach to the new intensified collaborative approach for dealing with arrears, Mr. El Kogali added, but only to point out the slow pace of movement since the U.S. chair had submitted a draft proposal the previous year and since the unofficial meeting of Sudan's creditors chaired by the Deputy Managing Director. Movement seemed to have been slowing at that time.

Mr. Marcel said that he agreed with the thrust of the staff paper. The continuing failure of Sudan to settle its arrears to the Fund was clearly not acceptable. Moreover, its practice of settling debt service payments to other creditors before doing so with the Fund was highly regrettable, as it placed a financial burden on other Fund members and reduced the amount of resources available to help members in need. Such discrimination against the Fund was unacceptable. It was worthwhile to note that Sudan's arrears to the Fund represented more than 25 percent of the country's total arrears and that they were equivalent to about one quarter of the deferred income covered by burden sharing. Therefore, he strongly urged the authorities to make partial payments to the Fund, which would certainly facilitate the normalization of relations with the institution.

It was also important for the authorities to pursue their dialogue with both the Fund and the World Bank in an effort to design a comprehensive adjustment program enabling the country to address structural and economic imbalances in line with the current reconstruction program implemented to tackle the consequences of the recent floods, Mr. Marcel continued. With respect to macroeconomic policies, he could only agree with the staff that further measures were needed, especially in the fiscal and exchange rate areas; it was of the utmost importance that those measures be implemented in a timely fashion to avoid the recurrence of past slippages. Furthermore, it was a necessity for the authorities to adopt the structural measures recommended in paragraph 4 of the staff paper expeditiously.

The Sudanese were facing a very difficult situation, Mr. Marcel agreed. However, he was convinced that the adoption of more stringent and comprehensive policies was the prerequisite for the country's dealing with its situation. It was clear that normalization of relations with the Fund would greatly facilitate that process.

Mr. Enoch said that the most recent review of Sudan's arrears offered some positive prospects for a resumption of progress in the collaborative effort to resolve the problem. The recent Consultative Group had helped to address Sudan's reconstruction needs arising from the disastrous flood of late. Paradoxically, as the staff paper showed, export proceeds for the current financial year would apparently be boosted by the impact of the flood on rain-fed agriculture; and the availability of foreign exchange was being augmented by the "own resource" import scheme. The authorities' outlining of a timetable for instituting a comprehensive adjustment program was particularly welcome. Some of the necessary measures had been identified in the 1988/89 fiscal budget announced in

June, and a start had been made in implementing structural measures in two out of the five highlighted areas. Further fiscal measures were due to be taken by the end of the year. There had been some movement on the vital issue of the exchange rate, which had reduced that rate's overall misalignment and that pointed in the right direction toward the objective of unification at a rate that could stimulate export diversification and import substitution, could spur the growth of inward remittances, and could enable the remaining parastatal enterprises to operate without fiscal subsidies.

Policy movement, in terms of the full implementation of the announced measures and their timely elaboration into a comprehensive program, would be critical for sustaining the credibility of Sudan in the eyes of the international financial community, Mr. Enoch observed. In adopting its Program of Action, Sudan was the first of the Fund's ineligible members to start to take significant steps toward overcoming the problem of arrears. That effort had brought forth a commensurate response from international donors. However, the program seemed to have stalled--especially in the area of public expenditure restraint--even before the adjustment efforts were suspended following the flood in August, and had clearly dissipated the goodwill and momentum that had been building up toward intensifying collaboration through the support group process. The flood had increased the urgency of adjustment, and the provision of reconstruction assistance did not reduce that urgency. However, further donor efforts were likely to continue to be linked closely to a resumption of credible policy reform by the authorities.

A comprehensive adjustment program must obviously be central to any effort to resolve Sudan's problems, Mr. Enoch stated. The approach pursued thus far had been piecemeal, and risked overburdening individual instruments, such as the exchange rate, and could also generate unnecessary friction that could derail the entire adjustment process. The staff had identified a clear risk of that sort if the supply and demand in the official foreign exchange market were not balanced, and if the correction of the exchange rate was not passed through into domestic prices. He fully endorsed the staff in urging the authorities to avoid creating new distortions that would jeopardize the progress that had been made and risk the political capital of the authorities' courageous commitment to reform.

He welcomed the recent payment by Sudan, but it nevertheless continued to be a particular cause of concern that the authorities had failed to respond to the Board's urging to demonstrate good faith, and had made only very limited repayments since the past review, allowing the stock of overdue financial obligations to accumulate further, Mr. Enoch commented. A cooperative relationship with the Fund--and especially an intensified collaborative approach--had to be judged in terms not only of the full and timely implementation of appropriate policies, but also of regular priority repayments directed at reducing the outstanding stock of arrears to the Fund.

He could endorse the proposed decision, but had two comments to make, Mr. Enoch remarked. First, he fully endorsed the reference in the draft decision to the payments made by Sudan to other creditors, and he strongly agreed with Mr. Marcel that it was unacceptable. Moreover, it was unacceptable that of the payments shown for July-September 1988, almost 90 percent had been made to either the World Bank or to the Fund's host authorities. Second, it was not entirely clear to him that the Board should continue to send only messages to Khartoum, and not also make representations to creditors. The Board would no doubt return to that issue in its forthcoming review of the intensified collaborative approach, which would be one of a number of discussions that Directors would shortly be holding on the arrears strategy. It was important that the Board referred to that strategy in its decisions. He therefore suggested that a sentence be added to the beginning of paragraph 4, which could be the same as that agreed by Directors the previous week for Viet Nam. He could support April 30 as the date for the Board's next review of Sudan's arrears, on the understanding that an oral report would be given by the staff when the proposed mission returned.

Mr. Ayales said that the authorities' efforts to implement the ambitious Program of Action in the face of discouraging and adverse circumstances was, indeed, highly commendable. Civil disturbances, drought conditions, and a shortfall in foreign aid receipts in 1987 and 1988 had been compounded by the heavy rains and floods in September, with catastrophic consequences. It was, nevertheless, very encouraging to see that despite the heartbreaking situation described by Mr. El Kogali, the authorities remained fully committed to the four-year Recovery and Development Program.

The far-reaching and wide-ranging structural measures being implemented in the areas of price and profit control, export trade, producer prices, and the parastatal sector were welcome, Mr. Ayales commented. At the same time, the authorities were also implementing fiscal measures to contain expenditure and to increase revenue and, within the limitations imposed by the prevailing social and political situation, they had moved toward adopting a more flexible exchange rate system. While there was disagreement with the staff regarding the modalities and timing of exchange rate adjustments, the authorities did share the staff's ultimate objective of establishing a unified exchange rate.

The authorities' collaborative approach to relations with the Fund and their continued efforts to adapt their policies to the unstable situation were commendable and deserved the support of the international financial community, particularly in an effort to find a more permanent solution to Sudan's external arrears, Mr. Ayales considered. He understood that, under current circumstances, adjustment measures could not have as positive an effect on production and exports as they would otherwise. Nevertheless, the recommended corrective measures were essential, especially those aimed at strengthening the public sector finances; the authorities should be encouraged to proceed in that direction. The agreed timetable for sending Fund missions to Khartoum was welcome, and he hoped that understandings on economic objectives and policies could be reached soon.

In supporting the proposed decision and being fully aware of the severe constraints currently facing the country, he encouraged the authorities to make every effort to attach the highest priority to making payments to the Fund, Mr. Ayales remarked.

Mr. Mawakani made the following statement:

> On behalf of the countries represented by my chair, I express deep sympathy to Mr. El Kogali and the Government and people of Sudan for the natural disaster that occurred earlier this year.
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> The widespread devastation caused by the exceptionally heavy rains and floods resulted in a human tragedy, with two million people being rendered homeless. Understandably, this event diverted the authorities' attention from the economy's problems to the immediate task of relieving human suffering and arranging the provision of humanitarian assistance to the Sudanese people.
>
> With a great part of this task behind them, the authorities have since refocused attention on their commitment to continue implementing measures to address the various macroeconomic and structural imbalances facing the economy.
>
> Among the measures outlined in the staff paper and highlighted in Mr. El Kogali's opening statement is the recent modification of the exchange rate system in October 1988. I commend the authorities for this bold step, and I welcome their intention to manage the system flexibly, with a view to eventually unifying the two rates under the two-tier system.
>
> Also welcome are the additional revenue and expenditure measures that are under high-level consideration and that are planned for implementation starting January 1, 1989. Among these fiscal measures, Directors must recognize the social and politically sensitive issue of not granting wage and salary increases in fiscal year 1988/89. Directors should also recognize the substantial progress that the authorities have made in mobilizing political support for the formulation and adoption of sensitive economic and financial policies in the context of a comprehensive adjustment program.
>
> These efforts and the authorities' great determination should be reflected in the proposed decision. Thus, I suggest that an additional sentence be inserted at the beginning of paragraph 3, reading: "The Fund notes the recent measures taken

by Sudan toward addressing economic and financial imbalances despite the difficulties in policy implementation caused by the heavy rains and floods that devastated the economy." The inclusion of a passage like this would greatly encourage the authorities to maintain their spirit of cooperation with the Fund in seeking solutions to the economic and financial problems facing the country, and would help to put the authorities in a position to make payments to the Fund, however modest.

On the question of attaching the highest priority to making debt service payments to the Fund, I do not think that the authorities' commitment is in doubt; but Directors need to recognize that the payments made to other creditors have been necessitated by the authorities' desire to keep the economy running while ensuring that the basic food needs of the population were met. According to Table 1 of the staff paper on actual debt service payments in July-September 1988, about 52 percent of such payments went to the United States, mainly for wheat imports.

I encourage the authorities to continue with their adjustment efforts. In the spirit of the intensified collaborative approach endorsed by the Interim Committee, they should also endeavor to accelerate the formulation and adoption of a comprehensive adjustment program, which could elicit the necessary exceptional financial support and help Sudan to normalize relations with the Fund. I support the proposed decision, with the addition of my proposed amendment.

Mr. Goos said that he would be interested to know whether any conditions, such as the adoption of a comprehensive adjustment program agreed with the Fund and the World Bank and the clearance of arrears to both institutions, had been added to the commitment by donors and creditors of about $300 million at their recent special meeting. That question was relevant in that a significant part of the amounts committed would represent transfers from development assistance that was already in the pipeline. Directors should be aware that if commitments under the latter were exhausted, not much money would remain for a coordinated approach to helping Sudan clear its arrears with the Fund and to normalizing its relations with creditors in general. In that connection, he wondered whether the Bank would contribute to the disaster relief before arrears to the Fund were cleared. Furthermore, he wanted to know what management's current thinking was of how to proceed with the case of Sudan.

He agreed largely with the views of Mr. Enoch and Mr. Marcel on the situation, and was most concerned that virtually no progress had been made to normalize relations since the past review, Mr. Goos stated. The authorities had undertaken substantial efforts to adjust, but their failure to tackle the issue of arrears to the Fund, by making direct payments beyond the ones made to the SDR Department, raised difficult questions about their willingness to cooperate in a serious effort to seek a timely solution to the problem. Mr. El Kogali was certainly correct in saying that Sudan was unable to clear the arrears on its own, but that did not imply that the authorities would not be able to make at least partial payments to the General Account. The receipt of such payments, even token ones, could greatly enhance the willingness of creditors and donors to provide the financial support necessary for helping Sudan to clear its arrears to international institutions and to other creditors. As in other cases, the Fund should await such payments before considering initiating the intensified collaborative approach. Moreover, he would have some difficulties with the establishment of a support group before agreement had been reached between the authorities and the staff on an adjustment program. In the case of Guyana, the support group process had been initiated only after agreement had been reached on a shadow program; the first step, therefore, had to come from the country in arrears to the Fund.

The information that a mission had been invited to visit Sudan at the beginning of 1989 and that the authorities were contemplating adopting a comprehensive adjustment program was encouraging, Mr. Goos commented. He hoped that the initiative would lead to early success, and although he appreciated Mr. El Kogali's call on the Fund to demonstrate flexibility and realism in negotiating with the authorities, Mr. El Kogali would no doubt agree on the need for the Fund to insist on the restoration of medium-term balance of payments viability. The Fund should not compromise on that need, which should take due account of the political situation in the south of the country. The information provided by Mr. El Kogali on the initiation of a peace process was most encouraging, and he hoped to see early results from that process.

Mr. Rieffel made the following statement:

> My authorities are disappointed by developments in Sudan since the Board's past review of Sudan's overdue financial obligations to the Fund (EBM/88/129, 8/26/88).
>
> Two weeks ago, in response to Sudan's appeal for assistance in recovering from the serious floods of this August, I understand that donor countries announced substantial commitments of assistance. I note from the staff paper that the rains that produced the floods are likely to have a positive impact on agricultural production over the next year.
>
> By contrast, the authorities have strengthened their policy stance only marginally in order to contain the economic repercussions of the flood. They continue to follow an unbalanced approach in which critically needed structural reforms might be undermined by inappropriate macroeconomic policies with respect to the exchange rate and the fiscal budget. Of course, the scope and intensity of the structural measures included in the budget for 1988/89 are gratifying, as are the limited fiscal

measures that will go into effect on January 1. Stronger fiscal action is needed, however, and I cannot agree fully with Mr. El Kogali's view of the exchange rate system introduced at the end of October. It will be necessary to go further in this area in order to have an economic program that can be considered credible by the international financial community.

Even more, I regret that the authorities did not take advantage of the staff mission that went to Khartoum in November, by beginning intensive discussions on a comprehensive program. I support the follow-up mission scheduled to go to Khartoum in January to begin work on a program that would start in the middle of 1989, but I am concerned that this gradualist approach may very seriously complicate the process of normalizing relations with creditors and donors.

At the time of the Board's past review, there was relatively little discussion of Sudan's payments to the Fund, presumably because of uncertainties about the impact of the floods on Sudan's economy. The information provided in the staff paper for the current discussion, however, leaves me feeling that Sudan is not according the Fund the priority it deserves. While Sudan may not have the ability to eliminate immediately all of its overdue financial obligations, it does appear to have the ability to pay the Fund substantially more than it has paid so far. I am in full agreement with the view expressed on page 7 of the staff paper to the effect that the payments made since ineligibility was declared appear relatively small. While I welcome the news that Sudan has become current in the SDR Department as of today, this does not change my view of the matter.

The authorities have expressed interest in the collaborative approach endorsed by the Interim Committee this September; but collaboration is a two-way street. They cannot expect the Fund and the rest of the international financial community to make extraordinary financial efforts to help Sudan if they are not making an extraordinary adjustment and reform effort themselves. It is hard to avoid the conclusion that Sudan does not fully understand the central role that the Fund must play in normalizing relations with creditors and donors. If it did, it would be making a greater effort to prevent its arrears from growing.

To respond informally to Mr. El Kogali's question about the formation of a support group for Sudan, my chair's views are very close to those of Mr. Goos in believing that agreement on a shadow program or a policy framework paper, and a better effort to pay the Fund, are necessary before establishing a support group. Responding to Mr. Nimatallah's suggestion about the early establishment of an escrow account, my authorities have advocated this idea in the past and continue to believe that it is one worth pursuing in Sudan's case. As a first impression, however, the notion that charges due to the Fund would be paid from such an account is worrisome; charges should be paid directly by members.

With respect to the proposed decision, I would prefer to have a formal review within three months, but can agree reluctantly to hold the next review in four and a half months, with two considerations in mind: first, that the staff will visit Sudan in January and will provide an oral report to the Board on its return; and second, that the Board will be discussing at the end of January a staff paper on modalities for implementing the Fund's strategy for eliminating arrears, including remedial action.

Mr. Legg made the following statement:

Sudan is a most serious case of overdue financial obligations to the Fund, as it accounts for a little under a third of total outstanding arrears.

Exogenous factors have clearly played their part in the poor performance of the Sudanese economy over recent years. The authorities have had to contend with a persistent civil war--here, I welcome Mr. El Kogali's indication of progress on the matter--together with a serious drought and, more recently, widespread flooding. However, it must also be said that inappropriate policies and the failure to exercise appropriate financial restraint have also been a significant part of the story.

The agreement on structural policy reforms announced in the 1988/89 budget is therefore welcome. So too is the indication that the authorities are keen to pursue negotiations with the staff on a comprehensive program of adjustment. The chances of success, however, are small, unless these initiatives are also backed by tight fiscal control--with emphasis being placed on expenditure restraint, particularly with an eye to the prospective wage and salary increases for the coming year--and by an appropriate exchange rate. In the latter respect, I am not convinced that the recently announced creation of a commercial bank market alongside the existing official and "own-resource" markets is a step in the right direction. While that action obviously creates an exchange market that, on the face of it, may reflect market forces more flexibly, the integration of the commercial bank market into the existing two markets seems to compound unnecessarily an already distorted set of exchange arrangements. It is difficult to comment with any confidence in the absence of clearer details on how precisely this market will work. Apart from anything else, I note the staff assessment that exporters will be disadvantaged significantly in terms of the effective exchange rate available to them.

There is no doubt, given the very low level of reserves and the size of outstanding arrears to the Fund and to other creditors, that this case will be resolved in no other manner than slowly. I noted from the staff papers that the authorities have taken the view toward debt servicing that emphasis should be placed on meeting those obligations for which failure to remain current would have the most immediate disruptive impact on external inflows. This no doubt seems like good crisis management to the authorities, and I appreciate the points made by Mr. El Kogali about the constraints facing Sudan. Nevertheless, it should also be emphasized that there is a positive obverse to this approach, as a decision by the authorities to give greater emphasis to repaying the Fund would have a disproportionate beneficial impact in terms of enabling them to normalize relations with the international financial markets more generally. Hopefully, the payment announced today to the SDR Department foreshadows a more positive approach along these lines. Like Mr. Goos, I would like to see it followed up by repayments to the General Account.

It should be emphasized that the recent natural disasters that have beset Sudan, damaging and disruptive as they have been, also provide a unique opportunity for the authorities to "wipe the slate clean." The reconstruction program agreed with donors could also provide the seeds of a more thoroughgoing program of reform and adjustment, and I urge the authorities to pursue this objective vigorously. I agree with Mr. Enoch that an oral report by the staff following the January mission would be helpful.

There is no doubt some merit to Mr. El Kogali's point about the possible role of a support group in assisting the momentum of the collaborative approach, yet I urge the authorities to consider the very real benefits of pursuing agreement on an adjustment program, unilaterally if necessary.

As for Mr. Nimatallah's proposal for establishing an escrow account, this is an interesting idea that is worthy of further elaboration. Even so, the image of potential support group members having spare funds that they might lodge in such an account on Sudan's behalf, for want of a better place to put them, before such a group is officially formed, is a picture that I find difficult to grapple with.

I support the draft decisions and the amendment suggested by Mr. Mawakani.

Mr. Nimatallah said that the Fund should acknowledge the progress made by the authorities, and he thanked the latter for their clear intention of continuing along such a path. Even though he was skeptical about the Board's continued sending of decisions to countries in arrears to the Fund and believed that another procedure would have to be found, he supported the suggested addition by Mr. Mawakani of a further sentence to paragraph 3 of the proposed decision.

The Fund should emphasize to the authorities the need for paying at least the charges due, a prospect that was enhanced by the expected increase in agricultural output, the improved chances for peace, and the reconstruction program after the flood, Mr. Nimatallah pointed out. He asked Mr. El Kogali to again make an extra effort to convince his authorities to pay at least the charges, as the amount of trouble created by unsettled charges was doubtless obvious to them.

There was no question that the authorities were willing to adopt new measures--it was just a matter of their feeling secure about financing and of having time to settle specific points with the staff about an adjustment program, Mr. Nimatallah remarked. Despite the fact that the establishment of an escrow account would give the authorities some security to make faster progress, and even though Directors could examine whether the Fund should accelerate the establishment of a support group, much still depended on the authorities, as greater efforts by them to formulate a comprehensive shadow program would encourage donors and creditors to commit funds and thereby speed the whole process of adjustment. He therefore appealed to the authorities through Mr. El Kogali to convince observers that they wanted to speed up that process, particularly given that the problems of flooding and civil unrest were almost behind them.

Mr. McCormack said that he remained concerned by the protracted nature of the economic imbalances in Sudan. While the recent floods had served to complicate an already difficult situation, he repeated the call made by his chair on other occasions that Sudan's problems required a comprehensive adjustment effort.

He agreed with Mr. El Kogali that the authorities' recent initiatives--under severely adverse circumstances--were commendable, Mr. McCormack continued. However, current policies, particularly exchange rate and fiscal policies, remained severe impediments to sustained improvements in the economic situation. The assurances given that the authorities intended to strengthen fiscal management by year-end were welcome, and he hoped that the discussions the staff would hold in early 1989 would, at least, lead to the adoption of the comprehensive adjustment program for which the Board had so long been calling, and which alone could form a realistic and credible basis for the development of the collaborative strategy on arrears for Sudan.

He noted the success achieved in obtaining donor funds to facilitate reconstruction after the recent floods, Mr. McCormack added. The authorities should not allow the size of those funds to lull them into a false sense of complacency; indeed, effective use of those funds could best be made in the context of an overall economic program. The comments of Mr. Legg on that point seemed to be germane.

The counterpart to Sudan's economic policies and performance would be a regularization of financial relations between Sudan and its creditors, including the Fund, Mr. McCormack noted. The distribution of payments, as enumerated in Table 1 of the staff paper, was disturbing, since it appeared to reflect a lack of priority by the authorities for normalizing relations with the Fund. The staff's assertion that the authorities continued to limit debt service payments to those debts that, if not settled, would have an immediate and significant impact on foreign exchange flows betrayed an unfortunate shortsightedness by the authorities and, perhaps, also by the creditors. As evidence of Sudan's cooperative spirit, he wanted to see a greater share of its debt service payments flowing to the Fund. The recent small payment to the Fund was welcome, but much more was called for on a regular basis.

He supported the proposed decision, including the amendment suggested by Mr. Mawakani, Mr. McCormack stated. The recommended timing for the next review seemed to be pragmatic, especially when supplemented by the proposed oral report by the staff following its January 1989 visit to Sudan.

Mr. Adachi said that his views of Sudan's arrears to the Fund were similar to those of Mr. Goos and Mr. Enoch. He welcomed the recent payment made by the authorities and urged them to intensify their efforts to repay the Fund. As elaborated by Mr. El Kogali in his opening statement, the progress made by the authorities was also welcome; despite the difficult situation, they had implemented structural and exchange rate reforms. Moreover, the favorable short-term outlook for production and exports was encouraging.

However, the measures taken thus far had not been sufficient to constitute sound economic management, Mr. Adachi noted. It was essential that the authorities formulate and implement a comprehensive adjustment program that could provide sufficient confidence to potential creditors and donors. In that context, he suggested that the Board be informed on a timely basis of developments in Sudan, and he would especially welcome an oral report by the staff after the upcoming mission returned. With respect to the support group, he associated himself with the views of Mr. Goos.

He welcomed the renewed prospects for domestic peace and supported the proposed decision, as amended by Mr. Mawakani, Mr. Adachi added. He was open to further amendments.

Mr. Chatah said that it was regrettable that progress toward resolving the problem of Sudan's arrears to the Fund had not been as fast as would have been desirable. Unfortunately, the environment for adjustment and reform in Sudan had continued to be extremely difficult since the Board's past review (EBM/88/129, 8/26/88).

Nevertheless, it should be acknowledged that the authorities had continued to move toward reducing the massive financial disequilibria and substantial distortions that had, for quite some time, severely hampered the realization of Sudan's growth potential and the achievement of external viability, Mr. Chatah continued. In that respect, he especially welcomed the reduction in the overall fiscal deficit envisaged for 1988/89, and the implementation of a number of important structural reforms, including a relaxation of controls over the prices of goods imported through the commercial banks and own-resource market, the removal of the monopoly on the export of certain agricultural commodities, the elimination of export licensing requirements, the setting of minimum export prices, and the modification of the exchange system. In the latter connection, the Board should note that it was important that the authorities make every effort to mitigate the exchange system losses that could result from the operation of the modified exchange system. He therefore welcomed the authorities' intention, highlighted in Mr. El Kogali's opening statement, to manage the two-tier exchange rate system in a flexible manner through gradually shifting commodities to the commercial bank market, with the ultimate objective of establishing a unified exchange rate.

The inclusion of an additional column in Table 1 of the staff paper on net debt repayments as a standard practice in future staff papers would be useful, Mr. Chatah suggested. He supported the proposed decision as amended.

Mr. Posthumus said that he generally agreed with other Directors' comments on the problem of Sudan's arrears to the Fund, while adding that it was untrue that management, the staff, Directors, or international donors had underestimated the size of the authorities' adjustment efforts. The latter point had been proven a few weeks ago during the Fund mission to Sudan. Nonetheless, many Directors were not fully convinced that the authorities' adjustment efforts were sufficient at the current stage; in fact, the authorities themselves had declared that the adjustment process was proceeding too slowly and were worried that there were no prospects in sight yet of reaching agreement with the Fund. He wanted to make those points because of his feeling that Mr. El Kogali had not yet fully grasped Directors' views.

The Director of the Middle Eastern Department said that slightly more than $300 million in assistance had been committed by donors and creditors at their recent special meeting on November 29, in comparison with the original request by the World Bank for $367 million. Of the $300 million pledged, about one quarter came from reprogrammed aid, with the balance of about $230 million representing emergency assistance.

No explicit conditions had been attached to the amounts committed, including that of the Bank, which, it was the Fund's clear understanding was coming from a nonpolicy conditional facility for providing emergency assistance, the Director continued. Nevertheless, in representing the Fund at the special meeting on November 29, he had made it clear that the emergency aid had to be viewed in the context of a medium-term framework for addressing Sudan's economic problems. The Fund had offered to monitor the measures that the authorities proposed to take on or by December 31, 1988, and to brief the donor community on the authorities' effort to implement such policies. Moreover, he had emphasized the crucial nature of the Fund's coming January meeting with the authorities, at which the staff hoped to reach agreement on the broad framework of a program. The staff would try to be as specific as possible in discussing policies, which, if agreed to by the authorities, could lead to the adoption of a shadow program for 1989/90. Furthermore, if the January mission was successful, he suggested that management might wish to consider forming a support group.

The Chairman said that a really credible program was needed before the Fund could call for the creation of a support group, as Governors would necessarily view that action as implying the existence of such a program. He drew Mr. El Kogali's attention to that point, and noted the importance of his role in helping the Fund to convince the authorities of the critical importance of the upcoming mission.

The Director of the Middle Eastern Department continued by saying that the communiqué issued at the end of the special donor meeting stated that, "the donors also held in prospect further substantial support for Sudan once the Government undertakes a comprehensive economic adjustment program and in the event of peace in the south. This would in turn assist Sudan to normalize its external financial relationships with creditors, and international and regional organizations."

Mr. El Kogali said that a gap existed between the thinking of creditors and donors, as represented in the Board, and that of the authorities in Sudan and the rest of Africa. At the most recent Annual Meetings, management had recognized the authorities' efforts to cooperate with the Fund; he hoped that, in the communication to the authorities, recognition would be given to their greater efforts than those of other governments in arrears to the Fund. Such a message would encourage the authorities, as would the creation of a support group, which would provide a practical incentive to cooperation, instead of the usual practice of sending a message to the authorities expressing the Fund's regret and of asking them to do the impossible task of becoming current immediately. Perhaps for cultural reasons, the authorities did not take repeated messages of regret seriously, particularly in view of the country's need to have at least some reserves to cope with unforeseen crises, such as the recent floods.

The mere formation of a support group, made up of concerned creditors, such as the United States, Saudi Arabia, and the Netherlands, would be a productive step forward, Mr. El Kogali went on. Furthermore, a support group should be the parallel to the authorities' willingness to adopt and implement adjustment measures, a point that he believed the U.S. chair had advocated previously in asking management about the steps that it planned to take to encourage the authorities to draw up and implement an adjustment program. It was not difficult to draw up a program; indeed, the authorities were working with the staff on doing just that, and had adopted a two-tier exchange system after initially resisting any changes to the exchange rate. The two-tier system was working well, as it was attracting recorded transfers of over $1 million a day from expatriate workers, in comparison with none before or with the previous transfers to the black market and/or a neighboring country. In any event, the key issue remained whether a program was implemented; and to do so required the immediate formation of a support group that would disburse assistance in parallel with actions by the authorities to implement a program.

Creating such a support group would help to improve the image of the Fund, a question that was thus even related to the issue of overdue financial obligations, Mr. El Kogali pointed out. The Board wanted to see action by members, while members wanted to see action by the Board; forming a support group would be a positive first step in that respect. As requested by the Chairman, he would make every effort to bridge to gap between the authorities and the Fund.

The Chairman said that an important clarification needed to be made. The exclusive instrument, endorsed unanimously by the membership, for dealing with arrears to the Fund was the collaborative strategy. The Fund could neither afford a failure in relying on that strategy or, indeed, fail to rely on it where it offered a promising avenue toward a solution. Therefore, the Fund was and must remain reluctant to use the formation of a support group as a conditional instrument for getting countries to take further action. Even though the Fund was committed to putting together a support group within the collaborative strategy, it could move only once it was satisfied that a credible program was in place. The membership had placed its trust in the Fund in helping countries to develop programs, and the Fund had to live up to that mandate.

He respected Mr. El Kogali's knowledge of the decision-making processes and conditions in his country, Sudan, but Mr. El Kogali should explain to his authorities that it was not up to the Fund to create a support group at any moment it chose, the Chairman stated. Assembling a support group was, instead, a process implying the participation of different parties and the holding of unofficial discussions between management and the country concerned. Unofficial discussions with the authorities could obviously begin before full agreement was reached on a credible program; and in the meantime, the authorities could inform concerned donors and creditors through diplomatic channels that they might be asked to commit themselves to participating in a support group. Sudan should start to explore such possibilities with other countries, while discussing a new shadow program with the Fund. The authorities also could rely on the Fund to start thinking about how best to assemble and operate a support group within the collaborative strategy. Cooperation and the most efficient use of the new strategy were crucial to the resolution of the problem of overdue obligations, and the Fund could not afford to fail in that effort. The staff and management would thus ensure that time was not lost in dealing with Sudan's difficulties.

The staff representative from the Treasurer's Department suggested that paragraph 2 of the proposed decision be amended to recognize that Sudan had made more than one payment of modest size to the Fund.

Mr. Nimatallah recommended, with respect to Mr. Mawakani's proposed amendment to paragraph 3, that the first sentence of that paragraph read: "While welcoming the implementation of important structural and macroeconomic policies, the Fund reiterates...."

Mr. Rieffel added that Mr. Nimatallah's proposed amendment might be further modified to read that the measures being welcomed were, "a number of structural and macroeconomic policy reforms."

The staff representative from the Treasurer's Department, in response to a request by the Chairman, suggested that, with respect to the proposed addition by Mr. Enoch to the beginning of paragraph 4, a sentence similar to that used in the recent decision on Viet Nam's arrears to the Fund might read, "the Fund will shortly be discussing its policies on arrears to the Fund." The next sentence could continue, "It will review the matter of Sudan's overdue financial obligations to the Fund again not later than April 30, 1989, in light of these discussions and of the actions taken by Sudan...."

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Sudan's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/88/249 (12/6/88).

2. The Fund deeply regrets the continuing failure by Sudan to settle its arrears to the Fund, which are placing a financial burden upon other members and reducing Fund resources needed to help others. The Fund notes that only modest payments have been received from Sudan since the previous review while Sudan has continued to make payments to other creditors. The Fund again urges Sudan to make prompt and full settlement of its overdue financial obligations to the Fund and stresses that settlement of these arrears should be given the highest priority.

3. While welcoming the implementation of a number of important structural and macroeconomic policy reforms, the Fund reiterates the importance of formulating and implementing a comprehensive program of economic adjustment within a medium-term framework designed to address the imbalances of the

Sudanese economy, which could provide the basis for the development of an intensified collaborative approach to the resolution of the problem of Sudan's arrears to the Fund.

4. The Fund will shortly be discussing its policies on arrears to the Fund. It will review the matter of Sudan's overdue financial obligations to the Fund again not later than April 30, 1989, in the light of these discussions and of the actions taken by Sudan in the meantime to settle its arrears to the Fund and to adopt and begin implementing a comprehensive economic adjustment program.

Decision No. 9042-(88/179), adopted
December 12, 1988

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/88/178 (12/12/88) and EBM/88/179 (12/12/88).

4. OMAN - 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 Oman to not later than December 21, 1988.

Decision No. 9043-(88/179), adopted
December 12, 1988

APPROVED: June 20, 1989

LEO VAN HOUTVEN
Secretary