

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/70

3:00 p.m., May 4, 1988

M. Camdessus, Chairman

Executive Directors

A. Abdallah
F. Cassell

J. de Groote

M. Finaish

J. E. Ismael

G. A. Posthumus
C. R. Rye

A. K. Sengupta
K. Yamazaki

Alternate Executive Directors

E. T. El Kogali
C. Enoch
Jiang H.
A. Rieffel, Temporary

E. V. Feldman

B. Goos
K.-H. Kleine, Temporary

L. M. Piantini, Temporary
D. McCormack
N. Toé, Temporary
I. A. Al-Assaf
B. Fuleihan, Temporary
C. Noriega, Temporary
M. Fogelholm
D. Marcel

A. A. Agah, Temporary
L. E. N. Fernando

S. Appetiti, Temporary

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

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Also Present

IBRD: E. Grilli, Operations Staff; N. Gorjestani, Africa Regional Office. African Department: E. L. Bornemann, Deputy Director; G. E. Gondwe, Deputy Director; G. S. Devaux, I. A. H. Diogo. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; A. Basu, B. Christensen, M. Frenkel, H. Hino, M. Nowak, R. L. Sheehy. External Relations Department: P. E. Gleason. Fiscal Affairs Department: F. L. Corformat. Legal Department: A. O. Liuksila, J. M. Ogoola. Middle Eastern Department: M. Yaqub. Treasurer's Department: T. Leddy, Deputy Treasurer; D. V. Pritchett. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. G. A. Faria, S. M. Hassan, P. Kapetanović. Assistants to Executive Directors: N. Adachi, F. E. R. Alfiler, J. R. N. Almeida, H. S. Binay, R. Comotto, E. C. Demaestri, F. El Fiky, S. K. Fayyad, S. Guribye, C. L. Haynes, K. Kpetigo, V. K. Malhotra, D. V. Nhien, J. K. Orleans-Lindsay, G. Seyler, C. C. A. van den Berg.

1. POLICY FRAMEWORK PAPER AND AID COORDINATION, AND RELATED ISSUES -
REPORT ON FUND/WORLD BANK SEMINAR

The Executive Directors continued from the previous meeting (EBM/88/69, 5/4/88) their consideration of a paper prepared jointly by the staff of the Fund and the World Bank on the discussion at a seminar, held on February 8-9, 1988, for senior officials of selected recipient countries and representatives of major aid agencies, development banks, the Commission of the European Communities, and the OECD, on the topic of the policy framework paper and aid coordination, and related issues (EBS/88/65, 3/23/88). They also had before them a background paper prepared by the World Bank reviewing its experience with the policy framework paper process (EBS/88/65, Sup. 1, 3/23/88).

Mr. Noriega made the following statement:

The staff paper is a synthesis of the views expressed during the seminar convened by the Fund and the World Bank to discuss with officials from recipient and donor countries, and multi-lateral institutions, issues connected with the policy framework paper. The wide range of views reflected in the staff paper point to the inherent contradictions that would arise in developing a more formal role for the policy framework paper. The case-by-case approach that is necessary to deal with the protracted problems of the poorest countries must be reflected in a diversity of form and content of policy framework papers.

The policy framework paper has perhaps succeeded in transmitting to potential donors the general purpose of framing financial aid in a medium-term program supported by the Fund. However, an attempt to provide more formality to the policy framework paper, be it in connection with the World Bank's activities or more active participation by donor countries, may stifle the impetus needed in the initial steps toward finding a common ground for the active and decisive support of authorities, the Bank, and the Fund.

The structural adjustment facility was originally established to provide concessional assistance to low-income countries in support of balance of payments adjustment efforts. It was agreed that, prior to the use of the facility, the authorities of the recipient country--acting jointly with the Fund and the World Bank--would produce a three-year economic policy framework paper, which would serve to give consistency to the program and facilitate the financial support of the Fund, the Bank, and potential donors. To a certain extent, this multiplicity of purposes gives rise to some of the problems discussed in the staff papers that arise in trying to accommodate the preferences of each of the parties involved.

It is not clear, however, whether the policy framework paper per se, or the final approval by the Fund of the program accompanying the structural adjustment arrangement request, is more important in attracting the support of donors. If the policy framework paper is more important in that respect, then it should be broadened and made more specific by defining more clearly the measures to be adopted and their timing, to accommodate the preferences of donors and creditors. However, if it is the Fund's support that prompts donors to extend aid, then it might not be worthwhile to develop the policy framework paper further; instead, we should concentrate on the Fund's own program. The flexibility necessary in a case-by-case approach precludes giving a definite answer to this question; instead, the staff should decide on the merits of each case. Moreover, under both alternatives the quality of the policy framework paper should not be at stake; only a good program raises the likelihood of achieving the stated objectives of increased growth rates and a viable balance of payments position. The problem is the extent to which the policy framework paper--which is a document aimed at publicity--should reproduce those elements contained already in the Fund's own program.

A good program is one that makes a realistic assessment of the amount of resources that will be available to support a country; thus, the assessment must necessarily gauge the donors' attitude and, of course, incorporate the World Bank's programs. However, it seems that a more formal participation by donor governments may end up introducing cross-conditionality, which, in addition to reducing the effectiveness of the policy framework paper, may prove to be unhelpful for the program. In the same vein, the Bank staff paper and the comments of the staff representative from the Bank provide very strong arguments against a more formal involvement of that institution through the policy framework paper. Perhaps because we are more familiar than before with the Bank's operations, we may realize that the outer limits are being approached in seeking to have the Bank provide the policy framework paper with a formal role in the approval of loan programs. I agree entirely that collaboration should be a two-way procedure, and that, with the Fund's own assistance, informal Bank support may be more effective if pursued in accordance with the guidelines stated in the policy framework paper.

The content of the policy framework paper should provide a long-term perspective, even if policy measures for only three years are explicitly considered. The positive effects of structural adjustment may take longer than three years to manifest themselves, which should be made apparent in the policy framework paper, but should not inhibit the Fund, the Bank, and donor governments from strongly supporting programs.

As the structural adjustment facility is still relatively new and given the coming activation of the enhanced structural adjustment facility, we should maintain an adaptable attitude with respect to recipient and donor preferences, and should therefore continue to review the experience with the structural adjustment facility procedures, in general, and with the policy framework paper, in particular.

Mr. Al-Assaf made the following statement:

In its short history, the policy framework paper has evolved as a useful tool for determining the program of action for borrowing countries, although it will take some time to fully establish the precise identity of the paper. Finding the policy framework paper's identity will come about by making it more helpful to all its users.

The primary user is, of course, the recipient country, and I strongly share the view that closer and fuller participation of recipients in the preparation of the policy framework paper is essential. Increased recipient country involvement will ensure not only that the priorities of the country itself are fully reflected in the policy framework paper, but also, and more important, that recipients are committed to the success of the policies to the fullest extent possible.

The staff paper puts forward a number of reasons explaining why the degree of participation of recipients may not always be as great as desirable, and I broadly agree with them. These considerations do not imply, however, that we should not try new avenues to increase the attractiveness of policy framework papers to recipient countries. In this light, efforts could be made, in appropriate cases, to give a longer-term perspective to the policy framework papers, which would have the advantage of taking into account the genuine concerns of recipient countries about the long-term needs and requirements of their economies. Contrary to the issues at the center of the adjustment program, the long-term needs of a country can be discussed outside the negotiation process implied in the policy framework paper exercise. In such a framework, the concurrence of recipients with at least the broader objectives of the program could be secured more easily. Inclusion of longer-term perspectives would offer the additional advantage of facilitating the general approach of donor countries to the difficulties faced by recipients. In the majority of cases, the links existing between donors and recipients reflect a combination of historical, cultural, and other factors. Relations based on these factors are, by definition, long-term, and therefore, donor countries understandably tend to

and like to frame their assistance in a long-term perspective. This perspective could usefully complement the present policy framework papers.

The possibility of involving donors in the preparation of policy framework papers to the greatest extent feasible is obviously welcome, but for practical reasons, the existing arrangements are still preferable.

Fund/Bank collaboration has been enhanced by the joint efforts on the policy framework papers, and although this cooperation is welcome, we should pay due attention to the potential cost of these efforts, and particularly to the importance of avoiding cross-conditionality.

Two steps could help to enhance the usefulness of the policy framework paper to the World Bank. First, greater involvement by the Bank staff in the preparation and discussions of the policy framework paper, which will eventually lead to the second step, namely, greater emphasis on sectoral policies. Table 3 of the Bank staff paper shows the lack of emphasis on sectoral policies. Only agriculture and, to a lesser extent, industry, received sufficient attention in previous policy framework papers. Sectoral developments are an integral part of the Bank's operations, and a wider coverage of them in the policy framework paper would therefore be helpful.

Mr. Fogelholm made the following statement:

I broadly endorse the conclusions that emerged at the seminar on the role and content of the policy framework papers.

The seminar was a success, and was particularly useful for the participating aid agencies, which became both more aware of and involved in the policy framework paper process. It is to be hoped that the papers could be utilized increasingly by aid authorities, and if not for aid cooperation itself--which might be too optimistic or even unrealistic to assume--they should at least be used as the central policy framework for aid.

The first and foremost conclusion of the seminar was that recipient country involvement in the preparation of the policy framework papers ought to be enhanced. Indeed, the usefulness of these papers can be severely questioned if the recipient governments do not feel committed to the policy recommendations contained therein. It has been noted already by many Directors that this involvement will require much more preparation time than has been the case thus far. However, it was pertinently observed by one of the developing country seminar participants that in most cases, the policy framework papers have been drafted

in a great hurry, on the specific request of the country requesting a structural adjustment arrangement, which was anxious to receive an early disbursement under the arrangement, thereby in practice precluding any meaningful participation by the government itself. The appropriate conclusion is that it is very much up to the recipient country itself to start the policy framework paper process in sufficient time so that the necessary political discussions can take place within the country, thereby ensuring that the draft policy framework paper is consistent with national policy aspirations.

The policy framework paper's instrumental role in increasing and improving Fund/Bank cooperation is very welcome, as is the expanding involvement of the Bank staff in drafting the papers. However, it is indeed worrying to hear that the Bank Board hesitates to give the policy framework paper process stronger support, although we hope that the positive trend in collaboration that has evolved will be continued. Collaboration should be continued in the present flexible and pragmatic manner; my chair does not, at this stage, favor more institutionalized forms of cooperation. In this context, I share Mr. Goos's views on the importance of delineating the different responsibilities of the two institutions; it is a cause for some concern that the Bank, on certain occasions, has provided countries with macro-economic advice and that that has been in conflict with the Fund's. This practice is, of course, highly undesirable.

I agree with Mr. Marcel's important points that the multi-scenario approach should be avoided in the policy framework papers, and that the World Bank and the Fund should make every effort to eliminate possible divergences of views and present only one solution in the papers.

Mr. Posthumus made the following statement:

The staff paper on the policy framework paper seminar is interesting because it reflects the multitude of views on what a policy framework paper should be and, hence, the different backgrounds of participants. I support the conclusions of the staff and I will make several basic points. First, although the policy framework paper should indicate priorities in the structural adjustment process, it should remain a framework, not a development plan. Second, the recipient countries should be more involved in the preparation of the policy framework papers. Third, the involvement of donors should be informal, although from a formal point of view, I rather like Mr. Yamazaki's approach, under which the involvement of donors should be through the recipient government. Fourth, the policy framework paper should be a means to coordinate and delineate Fund and World Bank activities.

There are different points of view in the Board on even the main aim of the policy framework paper. For instance, Mr. Zecchini stressed its role as a policy document, while Mr. Cassell underlined the objective of promoting systematic coordination of all financing sources. Furthermore, I do not sense great support for the policy framework paper process by the Directors elected by the countries most concerned, and I am not sure in which direction the managements of the Fund and Bank would like to go. Furthermore, how far do they propose to go toward having an all encompassing document or a short paper with limited purposes? It appears that the Boards of the two institutions may think differently about the policy framework paper, as Mr. Cassell and Mr. de Groote have told us. One should perhaps not automatically conclude that the Boards are wrong in thinking differently on the policy framework paper, or that one of the two Boards is incorrect. It is common knowledge that in a number of countries the staffs have different approaches to the process which perhaps are not always in parallel with those of their own Boards. These differences should not be minimized, and we should not conclude too soon that the process is developing in the right direction.

The cause of my uneasiness is that I do not feel or sense in which direction we are moving. Are we with the policy framework paper supporting or stimulating a continuing movement into longer-term Fund financing--for instance, with the enhanced structural adjustment facility--and gradually defining away the rationale for typical Fund financing, which is short-term adjustment and which will be needed by recipient countries at some point in their future? In talking about coordination between the enhanced structural adjustment facility and the donor agencies, are we implying that the Fund is just another donor agency? Do we think that a policy framework paper is a policy instrument that obviates the need to tackle short-term problems?

Alternatively, will the policy framework paper clarify what the delineation between Fund and World Bank should be? What are the stabilization and adjustment elements within the policy framework paper, and what is the role of macroeconomic policy and policy advice? What policy areas should the Fund coordinate with the Bank--in fact, the structural aspects--and which areas should the Bank stay out of--monetary, foreign exchange, and interest rate policy? What are the structural, longer-term development problems that the Bank should tackle, and where should the Fund stay out--the organization of markets, and the functioning of parastatals?

It is not certain that we can agree on the direction we should take. It is tempting to say that, perhaps, at first, the Fund and the World Bank should delineate their responsibilities; the Bank perhaps has more to do in this field than the Fund. We

can never totally solve this problem--bureaucracies, especially larger ones, are tempted to try to bring everything under their control and not leave much jurisdiction to other bureaucracies--but, we should be able to do better. The more ambitious task of using the policy framework paper as a unifying document for the presentation of the recipients' policies and the coordination of foreign assistance from all sources can perhaps then be tackled later on. After all, we should not think that in these latter two fields nothing has happened thus far; aid coordination, for example, is in many cases already a continuing and reasonably successful process.

Mr. Agah made the following statement:

It is important, at least for the record, to reiterate some general views on the subject despite the likelihood that industrial countries--which are the frequent decision makers in this institution--may remain indifferent to them.

As the staff rightly points out, the policy framework papers were "introduced one-and-a-half years ago as one of the requirements for qualifying for assistance under the Fund's structural adjustment facility." It is worth recalling that the structural adjustment facility was intended to replace the original Trust Fund, which had proven very helpful to member countries encountering difficulties in the late 1970s and early 1980s. The main characteristics of the Trust Fund were its low conditionality, quick disbursements, and concessional lending terms.

In line with what has increasingly become the practice in the Fund, instead of keeping intact such a useful instrument--the efficacy of which was acknowledged consistently by developing country Executive Directors--it was decided to create a new facility that was much more conditional and very difficult to implement, without paying due consideration to the constraints it was to impose on the staff and management. The only argument for such a replacement at the time was the yet to be realized promise that such "enhancement" would bring in new resources. Instead, in the meantime, we, in collaboration with the World Bank, have created a monster with a bureaucratic vehicle called the policy framework paper. As if this was not sufficient, the staff is suggesting that donors and creditors become involved in the preparation of the policy framework papers.

A year and a half later, 25 programs have been put in place, four of which, according to the latest staff report, have become inoperative because of the members' overdue obligations, while

two others have been associated with inoperative stand-by arrangements because of the nonobservance of performance criteria. The amounts that have been transferred under the new facility are a dismal average of SDR 23 million per country.

Given that the complexities of the structural adjustment facility have surfaced, and that the results have fallen far short of the aims and efficient means of the Trust Fund, it has been decided to "enhance" the newly created facility by creating yet another one. These comments are not meant to belittle the Chairman's strenuous efforts on behalf of the two new facilities. It seems, however, that we should currently draw the lessons from recent experience and relax the conditionality associated with the enhanced structural adjustment facility if we really intend to make this facility a powerful vehicle for the transfer of resources to low-income countries and to support the type of reforms compatible with the social, economic, and political situation of the countries concerned. If we insist on imposing preconceived solutions, we are bound to end up with a growing number of inoperative programs.

In devising help for low-income countries we should keep in mind that their problems--even if compounded partly by poor management--stem mainly from exogenous factors, including, inter alia, drought, sharp and continued deterioration in their terms of trade, heavy debt service payments, the reliance on one export commodity. We should also take into account the fact that most of these countries lack the necessary data and manpower to devise medium-term policies, especially in the prevailing unstable world economic environment. In addressing industrial countries' problems we show extreme sensitivity to the fragility, volatility, uncertainty, and provisional character of policies that at times have to shift abruptly to meet the wishes or requirements of this or that major country; but when it comes to developing countries--even those equivalent in size to a small city in the United States, Europe, or Japan--we insist on having a meticulously prepared scenario covering three and sometimes five years. Therefore, we should revert to the spirit, if not the letter, of the Trust Fund in dealing with these members if we really intend to help them and are to avoid the multiplication of problems that are associated with overdue obligations. It is very unlikely, however, that such an approach will be adopted.

The content of the policy framework paper should reflect the priorities of the reform efforts, but it should be more general in nature than at present. It is presumptuous to expect that, for most of these countries, all key problems and measures to be taken will be identified with a clear timetable for specific policy actions. In addition, it is difficult to see how a longer-term perspective could be contemplated in these cases, since the vagaries of the weather, or deterioration in the terms

of trade can destroy reform efforts by the equivalent of 5 to 6 percentage points of GDP in a single year. I agree that some assessment of the social dimension of the adjustment and a country's institutional capacity should be provided if the logical conclusions of that assessment are drawn; in other words, such assessments should usually be a reason for softening conditionality, not tightening it.

The participation of recipient countries in the preparation of policy framework papers is essential for the success of a program. Such participation should not be limited to the technical and bureaucratic aspects of the paper, but should encompass the authorities' views on the feasibility and timing of the proposed reforms. We should not try to impose a program that is ready to implement or that is prefabricated, as has been the case thus far and has been admitted implicitly by the staff. We should strive to somehow tailor programs to suit the particular circumstances of the country concerned. In this respect, I wish to recall this chair's proposal relating to the institution of a special and simplified procedure in cases in which there is lack of data or institutional capacity to implement strong reforms, or when problems of security may interfere with the implementation of the program.

Donors should not be involved in the preparation of policy framework papers; rather, they should be informed of the conclusion of structural adjustment arrangements, with the proviso that the recipient countries should be kept fully informed of such contacts. Involvement of donors at the negotiating stage can only complicate matters and undoubtedly lead to harsher, and at times, unrealistic conditionality.

Even though I have advocated Fund/Bank collaboration in this area, more flexibility is needed, especially as the World Bank is not contributing directly to the resources of the enhanced structural adjustment facility. The staff implicitly admits that the World Bank does not use papers as the basis for its parallel action, which constitutes an additional burden on the authorities, as there are strong reasons for believing that the Bank continues to send separate missions to these low-income countries.

Mr. Rieffel said that he wished to respond to several points that had been made by Directors after Mr. Dallara spoke, and to offer a suggestion. The U.S. chair shared Mr. Marcel's concerns about the inclusion of alternative scenarios in the policy framework papers, and would elaborate more extensively on them in the coming discussion of Burundi. In brief, presenting alternative scenarios was inconsistent with the purpose of a policy framework paper, which was to outline a coherent and integrated approach to setting medium-term objectives that were both realistic and ambitious.

Moreover, although a number of Directors had emphasized the desirability of having policy framework papers drafted by recipient countries to reflect the latter's priorities and objectives, the limits of moving in that direction would have to be recognized, Mr. Rieffel considered. From the beginning, the policy framework paper had been viewed as a document to be negotiated with the World Bank and the Fund. One would expect that a country's priorities would change during the process of negotiation as efforts were made to reconcile conflicting objectives and as the Bank and Fund staffs brought the experience of other countries to the attention of a government. If that did not happen, the policy framework papers would be less useful in mobilizing broader and more effective support.

Given the Chairman's invitation to the World Bank staff representative to sit at the table throughout the current discussion, it might be appropriate to do the same whenever the Fund Board was considering a policy framework paper, Mr. Rieffel concluded.

The Chairman replied that when policy framework papers were considered, World Bank staff representatives were in the room and were given the floor whenever questions that were relevant to their responsibilities were asked. Thus, he saw no need to change the current practice.

Mr. Goos said that although he recognized the advantages of having one scenario only in the policy framework paper, and such a scenario was consistent with the original objectives of the framework paper exercise, the problem was how to reconcile the apparently more far-reaching goals of the World Bank with the Fund's objectives. If the Bank wanted to include alternative growth exercises in various financing scenarios, those projections would apparently include financing that was not yet available and, hence, still had to be mobilized. How did one reconcile those different objectives without running the risk of having the Fund adopt a compromise scenario that was based on the requirement of unrealized or unsecured financing. Would the Fund not then move in the direction of becoming a development institution, and would it not--as he had noted in his opening statement--be held responsible for helping to close external financing gaps? He therefore believed that the World Bank should be given the opportunity to formulate more ambitious scenarios in the policy framework paper if it insisted on so doing, and if such scenarios were considered to be a condition for the Bank's continued collaboration in the policy framework paper process. The more optimistic scenario should be put in the annex of the staff papers and be identified clearly, so that it could be distinguished from the Fund's approach of reaching medium-term viability in an appropriate time period and on the basis of available resources.

The Chairman commented that it should not be forgotten that one of the central objectives of the policy framework paper process was to reconcile World Bank and Fund views of a country's medium-term prospects. If two scenarios were included in the policy framework papers, the country would have the problem of reconciling an apparently attractive World Bank medium-term projection, with its higher growth target, and another medium-term program coming from the Fund and designed according to the

availability of resources that could be reasonably expected to emerge. Therefore, although the inclusion of an alternative scenario could be a useful illustration, care would have to be taken to avoid giving authorities the impression that they could choose between the scenarios, especially as one scenario might at first glance seem more attractive than the other. It was important for the Fund and the Bank to examine realities together--or to combine a country's growth and financing possibilities into a credible and feasible program.

Mr. Goos responded that the problem began at the level of reality itself, which presently involved the different methods that the Fund and the World Bank used in making financing projections. The Fund's approach was more realistic in that it involved estimating financial flows that a country could reasonably expect to emerge, whereas the Bank put much greater emphasis on the desirability of obtaining certain growth objectives to meet a country's investment and import needs, which the Bank used to calculate the country's financing requirements. That approach was entirely legitimate for the Bank--which had to try and secure the needed financing to meet the growth targets--but it was his impression that the Bank was very often quite ambitious and sometimes seemed to project gaps that were larger than necessary to show donors how precarious the financial situation was in order to mobilize their support. The Fund should avoid the Bank's approach to estimating financing requirements but would find it difficult to do so if it concentrated on formulating a common scenario, which would blur the dividing line between the two approaches, and, hence, make it easy for the Fund to lose its identity.

Mr. Cassell said that he disagreed with Mr. Goos's views on the common scenario and with his description of the World Bank's approach to estimating financing requirements. That approach was unrealistic and therefore inappropriate; the Bank had to take into account the realities of the situation and, therefore, could not merely assume a growth rate and a resulting financing gap and then hope that the needed financing would somehow arise. On the whole, both institutions were tending to move into a middle ground in their methods of projecting financing requirements; something that they certainly had to do.

Mr. Goos inquired about the staff's view on the difference between the two growth scenarios in the policy framework paper that was to be discussed in the meeting on Burundi. Did the staff subscribe to the second, more optimistic scenario, and, if so, why was there a baseline scenario. There must be a difference in the quality of the scenarios, with the staff mainly supporting the first one and hesitating with respect to the second.

Mr. Posthumus said that there was already a need to reconcile the roles of the World Bank and the Fund with respect to the enhanced structural adjustment facility, and that had made him hesitant about the whole enhanced structural adjustment facility process. However, his concern had shifted somewhat in the direction of Mr. Goos's position in that even in those countries that had coordinated enhanced structural adjustment arrangements with Bank programs, there might still be a need in certain situations for

the Fund to play its traditional role of providing stand-by arrangements, which could never be entirely covered by the policy framework paper. Moreover, in that respect, he did not disagree with Mr. Cassell: the two institutions had different aims and should not become too close, although that difference did not diminish the need for coordination, but rather increased it.

The Deputy Director of the Exchange and Trade Relations Department commented that the staff firmly believed that a baseline scenario had to be agreed by all of the parties involved in the policy framework paper process, particularly during the first year of an arrangement. In Burundi's case, there could clearly be only one scenario. The real issues arose beyond the first year of an arrangement, when observers could, in good faith, come to different conclusions about the availability of external resources; but, even if those amounts and a country's capacity to use them efficiently were not optimal, it was critical that the problem of raising more resources for a country be addressed. The staff saw a role for addressing that question with scenarios, but agreement on the baseline scenario--which would direct the authorities' policy decisions and the attitudes of all the parties involved in the policy framework paper process--would have to be reached first.

The second, more optimistic scenario was not an endorsed one that guided the authorities and the program, the Deputy Director continued. It was very important that if a second scenario was to be included, the full implications of that scenario should be elaborated and further questions asked, such as: if additional resources became available, could they be absorbed efficiently and what the implications would be for the budget and for balance of payments viability and sustainability as far as debt servicing was concerned. The forecasts in the second scenario should not simply assume that there would be additional financing and then make a calculation of faster import and economic growth rates; that approach would not benefit anyone. As long as those who were involved in the policy framework paper process agreed that there was a baseline scenario, and as long as the authorities were not confused about the scenario on which the lending operations of the World Bank and Fund were to be based, presenting two scenarios was justifiable.

The different nature of the Fund Board's discussion, compared with the relevant discussion in the Bank Board the day before, was striking, the Deputy Director observed; in that respect, Mr. Cassell's and Mr. de Groote's remarks were welcome. In the Fund Board there was a certain agreement with the current evolution of the policy framework paper's role and with its attendant processes, particularly with respect to the questions about the content of the papers and the suggestions for further involving recipient countries in the process.

As he had stated at the seminar on the policy framework paper in February 1988, the staff was struggling to come to terms with the vast array of participants' aims in the policy framework paper process, the Deputy Director said. The policy framework paper was supposed to foster

Fund/Bank collaboration, help the authorities forge an internal consensus about the policies to pursue over the medium term, catalyze resources or trigger assistance from donors, and be used internally by the staffs to inform management and the respective Boards about the framework within which the two institutions' lending operations were taking place--either through structural or enhanced structural adjustment arrangements, or the Bank's structural adjustment lending. The policy framework paper was to be the authorities' own document to be presented to Consultative Groups and other fora to help raise additional resources; it was also supposed to help the Fund Board monitor progress under the three-year adjustment programs. That list of objectives was not an easy agenda to meet for a paper whose length was supposed to be restricted to 10 or 15 pages, and although the policy framework papers would continue to reflect all those aims, the Board would have to decide which goals were priorities. The first two objectives of using the policy framework papers, namely, to foster Fund/Bank collaboration or to forge and an internal consensus in a country, and to express it to the international community, should be the ones on which the Board concentrated. Some of the other aims could be achieved by cross-referencing them with other papers, or, in other words, by ensuring that the policy framework paper was seen within the whole complement of papers that were available from the World Bank and the Fund.

It was apparent, from the current discussion and the seminar, the Deputy Director noted, that there was little consensus for establishing new and formal procedures or fora to bring donors into the policy framework paper process. Instead, an informal and very flexible approach was favored, which the staff would certainly try to adopt. The staff would also keep Directors' offices informed of the contacts that were being made, which, on occasion, could be accomplished by having missions meet with the representatives of donor agencies in the field, or through recipient countries.

The use of the policy framework paper by donor agencies was not solely to raise additional assistance, although that function was an important one, the Deputy Director considered. The other functions of the policy framework paper were to bring consistency to the macroeconomic policy advice that countries were receiving from many different sources, to try to avoid duplication, and to include the other donor agencies that would be having those discussions and with which the Fund had to have contact to understand their concerns.

Among the suggestions that were made by Directors with respect to the composition of missions, it had been mentioned that the staffs of the Bank and the Fund should operate in the field under the same terms of reference, but that was in fact the case already, the Deputy Director remarked. Part of the problem was that the terms of reference--which were commonly established for the two staffs by having a draft policy framework paper prepared and cleared at headquarters--ran counter to the other major aim of bringing the authorities as soon and as much as possible into the preparation of the paper. It was not wholly a conflict, in the sense that it was not a process in which the staff sat down with a clean slate and described a set of policies that were then presented to the authorities. The writing

per se was not as important as the fact, that, in most cases, it was preceded by a dialogue with the authorities, and, hence, by an understanding of the authorities' desired policy direction. The World Bank had a continuous dialogue with the authorities through its many missions, as did the Fund in most cases, particularly when it had other lending arrangements with the countries concerned. The policy framework paper was therefore a logical extension of an ongoing process and dialogue with the authorities, which was the critical point to understand in trying to reconcile any conflicts between the terms of reference and the desire to include the authorities as early as possible in the drafting of the paper; the staff would, of course, continue to push for the latter.

As a recent example, in the case of Ghana, the staff and the authorities had written a draft outline of what they had anticipated would be the final version of the policy framework paper and a mission had gone to Ghana to discuss with the authorities exactly how the paper would evolve, the Deputy Director commented. At present, there was an interim period during which each side was doing its part of the work in preparation for a meeting at which a complete draft of the policy framework paper would be composed.

The staff had tried to gather a representative sample of recipient countries at the seminar in February 1988, the Deputy Director of the Exchange and Trade Relations Department concluded. Three recipient countries had been involved, including one that had just completed a discussion of a first-year policy framework paper and another that was near a second-year discussion. The staff had tried to involve country representatives who had been very actively involved throughout the policy framework paper process, and the staff had wanted to keep the seminar group small. The seminar's main purpose was not so much to cover all the issues concerning the policy framework papers and the evolution of the process, but to inform aid agencies of what the Fund and the World Bank were doing and to get donors' reactions to how they saw the process evolving.

The staff representative from the World Bank said that information about total lending and adjustment lending from the Bank to policy framework paper countries was contained in Tables 4 and 5 of EBS/88/65, Supplement 1, and in Table 1 of the Appendix, where adjustment lending was broken down by country. The tables showed quite clearly that there had been a vast increase in Bank resources both for investment and for adjustment lending to policy framework paper countries.

Three points were relevant to the World Bank's view of, and plans for, the policy framework papers, the staff representative from the World Bank continued. First, the Bank used the policy framework paper in the very important function of giving macro-policy advice to countries that was consistent with, and mutually supportive of, the Fund's advice. Moreover, as was indicated clearly by the financing flows to policy framework paper countries, the Bank used the paper as a guide for parallel action. Finally, the Bank planned to integrate the policy framework papers much more closely and systematically into its own internal operational processes,

for which various suggestions were heard the previous day at the Bank Board, ranging from referring to the papers in Bank structural adjustment lending documents, to referring to policy framework paper strategies in country strategy papers.

The Chairman made the following summing up:

Executive Directors have noted that the policy framework paper was a major innovation introduced less than two years ago, and have welcomed the substantial improvements that have been made as experience has been gained in the preparation of the policy framework paper and in the policy framework paper process itself. However, there was broad agreement among Directors that there remained scope for improvement to make the policy framework paper the succinct expression of the country's objectives and priorities, to develop the process further, to make the assistance of the international community to countries eligible to use the structural adjustment arrangement more effective and efficient, and to strengthen Fund-Bank collaboration.

Directors agreed that the content of policy framework papers should be selective in addressing key structural problems and should reflect the priorities of the reform effort. Policy framework papers should include a careful assessment of the adequacy and composition of the investment program and should be oriented around ambitious steps to eliminate the structural impediments to higher economic growth. Policy framework papers should be specific in the main policy areas, highlighting the principal measures to be taken and establishing a clear timetable of policy actions. Policy framework papers should set out clearly the evolution of macroeconomic and balance of payments aggregates upon which understanding has been reached among the authorities, the Fund, and the Bank, and which form the basis of the adjustment program. It should be made clear that the policies are formulated on the basis of the base scenario. When an alternative scenario is presented, the policy framework paper must make clear the limited circumstances under which it could apply, and its implications for the adjustment program should be fully described. Directors also supported the suggestion that there should be a clearer linkage of the policy framework paper with various supporting documents, with a view to avoiding duplication and keeping the policy framework paper concise and focused.

Directors strongly endorsed the view that recipient countries should play the key role in the preparation of policy framework papers. They emphasized the importance of forging the internal consensus necessary for the successful implementation of adjustment programs. The policy framework paper is to be an authentic expression of the country's objectives and policies--put forward with the assistance of the technical experience of the Fund and Bank staffs to ensure coherence and consistency. Many Directors

agreed that it would be necessary, in a number of cases, to allow for additional time in the preparation of policy framework papers--including more missions--to enable a full discussion of major issues before the policy framework paper is drafted, and thus to ensure that the authorities themselves initiate and formulate the policy reforms in the policy framework paper. However, this is a matter of degree, and any lengthening of the process must not add to the burden on the countries.

Directors felt that there was considerable scope for improving the catalytic role of the policy framework paper in providing systematic coordination of the main sources of external finance and in ensuring that financial assistance in appropriate amounts and forms is forthcoming over the medium term to support the adjustment effort. A number of Directors hoped that aid agencies would make increasing use of policy framework papers in their aid operations, thereby contributing to a consistent policy approach and a better coordination of the activities of those agencies, the Bank, and the Fund. Directors thought that closer staff contact with donor countries would be useful for some purposes, particularly when it can contribute to mobilization of larger financing flows, but they emphasized that such contacts should not result in delays in the preparation of policy framework papers, or in a complication of the aid decision-making process, and neither should it alter the nature of the structural adjustment facility and policy framework papers. Contacts should be informal, build on existing arrangements, and be tailored to suit institutional arrangements within the donor country. In all cases, the recipient government should be kept informed. Most Directors felt, however, that the formal involvement of donors in the negotiation of policy framework papers or in commenting on drafts of policy framework papers would not be appropriate. In order to reconcile possibly conflicting considerations, we will have to be prudent in the case-by-case implementation of this advice.

Directors thought that policy framework papers had contributed to improved collaboration between the staffs of the Bank and the Fund and to more consistent policy advice and prioritization by the two institutions. Directors urged the staffs to further extend and deepen their collaboration, keeping in mind the delineation of primary responsibilities between the two institutions, with a view to ensuring that full advantage is taken of the considerable specialized expertise that each organization has developed over the years. The staffs should each work within their own areas of competence, which should help to avoid cross-conditionality as well as delays in negotiations. Directors stressed that the consensus approach on policy issues and the appropriate path of adjustment that was developed in the context of the formulation of policy framework papers should be reflected in all aspects of the working relationship

between the two institutions and the member country. On procedures, suggestions were offered by some Directors for changes at the level of both Boards and staffs, but others expressed satisfaction with present procedures or suggested caution in considering possible changes. Finally, Directors indicated that it would be useful to transmit to the Bank a summary of the Fund Board discussion on policy framework papers. A number of Directors also expressed the hope that the policy framework paper would assume an increasing role in the structural lending operations of the Bank but others did not share that view and recalled the understanding that the framework paper procedure would apply only in the case of the structural adjustment facility and was not intended to apply to other uses of Fund resources.

I have also taken note of the suggestion that it might be useful to experiment with a policy framework paper-like document for some countries that are not eligible to use the resource of the structural adjustment facility. In light of the negative views expressed by some Directors on this possibility, it will need to be discussed further. For our part, we would be prepared to consider the feasibility of such an option with our colleagues at the Bank if a borrowing member country believed it to be useful.

Speaking personally, I would like to add some further points, especially in the area of collaboration with the World Bank.

Some of you thought that our collaboration could be improved through clearer guidelines on the division of responsibility between the two institutions. Mr. Goos thought that we should elaborate guidelines for this purpose, while Mr. Zecchini felt that the most effective cooperation could be achieved only through true commitment to collaboration by both institutions; I think that both Mr. Goos and Mr. Zecchini are probably right. There are areas, such as exchange rate policy, for instance, that are clearly an intrinsic part of the Fund's responsibilities. By elaborating guidelines, the action of the Fund staff could be facilitated, but it is an open question whether it would decisively solve all problems even in those areas.

There are also areas where defining guidelines would be very difficult; Mr. Goos, for instance, cited an example of assistance in banking reform. Such reforms may involve, for instance, selective credit policies aimed at industrialization, which, in my view, belong in the World Bank's sphere. At the same time, such reforms have macroeconomic and policy implications which are, of course, within the domain of the Fund. It would be rather difficult to formulate guidelines in all cases that would provide clear-cut guidance to the staffs of the two institutions in their day-to-day work. This is the reason why Mr. Zecchini's point on the spirit of collaboration is indeed

important, and is very much shared by both managements and staffs. This is also a reason why the informal dialogue with the Bank Board that Mr. Cassell and others advocated can also provide a useful contribution.

I would like to make a special comment on the thought-provoking remarks of those Directors who are members of both Boards. I was intrigued by the remarks of Mr. de Groote on the risk we could run if the Bank were not active in a particular member country; that is, the risk for the Fund of having to involve itself in areas that are not among its primary responsibilities. The Fund's management will strongly resist that.

We already have the guidelines on the division of responsibility that perhaps go about as far as it is practicable to go. The summing up establishing the structural adjustment facility in March 1986 stressed that, while closer Bank-Fund collaboration was of the essence, the competence, mandate, and expertise of each of the two institutions must be respected. The summing up stated that the Fund would pay particular attention to what it was best equipped to deal with: macroeconomic developments and policies, notably, adjustment of balance of payments disequilibria and stabilization programs, fiscal policies, monetary policies, exchange rates, exchange systems, restrictive practices, and price realignments. The Bank, according to the summing up and to good sense, has particular expertise and competence, inter alia, in development and sectoral policies, investment priorities, and microeconomic reforms.

Of course, in actual practice, there have been growing overlaps in some areas of interest, but these have not blurred the clear-cut primary responsibilities of both institutions. As the Interim Committee said in its communiqué, each institution has to take the lead in the areas of its primary responsibilities; this is obvious for the World Bank as well as for the Fund.

What should be done to improve collaboration? First, I am grateful to those who have recognized that progress in collaboration between the Fund and the Bank has been striking. Further progress is necessary, but what has been achieved so far should not be overlooked. In the future, it is vital that each institution continue to concentrate on its area of primary responsibility. Only in this way can each take full advantage of the expertise of the other and best serve our member countries. The basic principles underlying our collaboration with the Bank remain valid, and it is the responsibility of the two managements to monitor closely developments and to take advantage of new opportunities for cooperation; here, I recognize that the revitalized extended Fund facility can, and will, offer a new area for collaboration. I recognize the exceptional character of the policy framework paper but I remain interested in the suggestions

being made by the U.K. chair, especially insofar as they deal with how we could improve cooperation in outlining medium-term programs of recipient countries without incurring excessive bureaucratic procedures.

I would like to emphasize how frustrating it is for our members when there are differences of opinion between the staffs of the Bank and the Fund. We should not pretend that differences of view never arise; it is normal that they do, and indeed it is a clear sign that each institution is alert and concerned. Instead, our objective should be to reconcile differences quickly and effectively, and we will continue to work closely toward this end with our colleagues in the Bank.

At management and staff levels, we shall obviously ensure a strengthened degree of cooperation between the Fund and the Bank, but member governments also have an important role to play. They should ensure that their administrations--and here I have in mind particularly the creditor countries--are sending the same advice to their Executive Directors in both institutions. Recipient countries also have responsibilities and, above all, we need their help to avoid fomenting any atmosphere of competition between the two institutions. The basic objectives of the Fund and the Bank are the same, and collaboration between the two institutions will be fostered greatly if they are not regarded as two shops, so allowing a country to buy from the one that seems to be offering an adjustment which carries the lowest cost in terms of immediate effort.

2. BURUNDI - STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT;
AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on Burundi's request for the second annual arrangement under the three-year structural adjustment arrangement approved on August 8, 1986 (EBS/88/76, 4/4/88). They also had before them a policy framework paper for Burundi (EBD/88/118, 4/27/88).

The staff representative from the African Department said that the measures--summarized in items 1-7 on page 28 of EBS/88/76--that the Government intended to take before the current Board discussion had been implemented. In particular, the exchange rate had been devalued by 10 percent on February 25, and again on April 1 and May 2, but by different amounts, so that the cumulative adjustment was 13.5 percent in SDR terms.

Mr. Abdallah made the following statement:

Executive Directors will recall that we discussed economic and financial developments in Burundi in December 1987, in the context of concluding the 1987 Article IV discussions. At that

time, I expressed the view of my Burundi authorities that external factors, notably a 40 percent cumulative deterioration in the external terms of trade and transportation bottlenecks associated with the country's landlocked geographical location, had rendered unattainable some of the benchmarks and the quantitative performance targets for the first year of the structural adjustment arrangement and a linked standby-by arrangement covering 1986 and 1987. Nevertheless, my authorities have persisted with their adjustment effort and they are pleased to note the staff's fuller recognition that the measures that were implemented resulted in an improved economic and financial performance in 1986 in comparison with 1985. In 1987, as the staff also notes, however, the 43 percent decline in world prices of coffee--Burundi's principal export--had significant adverse effects for economic growth and resulted in a widening of the external and fiscal deficits and a sharp resurgence of inflationary pressures.

It is against this background that the authorities have recognized the importance and urgency of persevering with the adjustment process set in train in mid-1986 and, with the assistance of the staff, have formulated an appropriate second-year structural adjustment arrangement covering calendar year 1988, but with a medium-term perspective as reflected in the policy framework paper (EBD/88/118). The authorities ask that special attention be paid to the comprehensive sectoral listing in Appendix II of EBS/88/76 of the wide-ranging macroeconomic and structural measures that they have taken or propose to take. Accordingly, they fully endorse the staff's appraisal that these efforts should over the medium term help Burundi to not only achieve a sustainable rate of economic growth and a viable external position, but also maintain orderly relations with its creditors--including the Fund--in the context of increased liberalization of exchange and trade restrictions, and to eliminate the need for exceptional external financing by mid-1990. At the same time, however, my authorities are fully cognizant that, although the outlook has improved for coffee with average export prices currently at \$1.30 a pound compared with the \$1.10 a pound used in staff projections, there is unlikely to be any significant recovery to earlier price levels. As such, the prospective economic outlook for Burundi remains fragile and could again be adversely affected by external economic and transportation developments beyond the authorities' immediate control.

The staff paper sets out in detail the basis for the comprehensive set of macroeconomic and structural adjustment measures that my authorities propose to take in 1988; hence, I will only describe those measures that are of special significance.

On the macroeconomic front, the authorities' principal concern has been to contain domestic demand pressure emanating

from the deficit position of the public sector, while gradually reducing its net absorption of aggregate resources to promote an increased role for the private sector in the economy. It is recognized that this is particularly difficult to do in the context of the shrinking coffee revenue base and the urgent need for the Government to continue to undertake further development of the country's infrastructure and thus facilitate a more broad-based and geographically diversified development of the economy. However, on the revenue side, a restructuring of the tax structure is being implemented with the intention of reducing the budget's excessive dependence on revenues from the principal export crop. The transactions tax is being broadened to cover services, the tax on beer is being increased despite its significant socioeconomic and political consequences, an across-the-board statistical tax on all imports is proposed, and tax administration is being strengthened. All together these measures should result in a structural increase of about 25 percent in gross revenues.

On the expenditure side, increases in civil service hiring and the grant of local scholarship assistance are effectively being contained, while quarterly expenditure monitoring of budgetary targets has been formally instituted. Moreover, the authorities, with the assistance of the World Bank, have already drawn up a core public investment program (PIP) covering the period 1987-89, to be underpinned by the provision of budgetary counterpart funds in the framework of a public expenditure program (PEP) for the period 1989-91. Directors will note that, as these measures bear fruit, the overall budget deficit--excluding grants--is projected to decline from a peak estimated level of about 13 percent of GDP in 1987 to just under 4 percent by 1992.

External policies that are supportive of this fiscal stance are also being undertaken. As the staff correctly observes, a flexible exchange rate policy remains a central element of the Government's program to achieve a structural improvement in the balance of payments. Directors will have noted from the chart on page 16a of EBS/88/76 that over the past two years such a policy stance has enabled the authorities to fully correct for the real currency appreciation that had taken place between 1984 and mid-1986, so that the current level of the real effective value of the Burundi franc is back to the level of 1980, when the balance of payments was considered to be broadly in equilibrium. Here again, the emphasis is, as is shown in Table 7 of EBS/88/76, one of gradually increasing receipts from nontraditional exports and of building up a healthy cushion of reserves, by providing increased incentives for the development of such exports, particularly to regional markets. This export diversification effort aims at reducing the share of coffee in total export earnings from a peak of 84 percent in 1986 to about 59 percent in 1992. It is an ambitious target that will depend

crucially on the proper functioning of trade arrangements within the Preferential Free Trade Area of Eastern Central Africa and on the economic strength of its member countries. A corollary to significant export growth is that the import regime be liberalized through the elimination of quantitative import restrictions and through the rationalization of the import tariff. Here I would like to add a personal caveat on the liberalization of luxury imports. I recognize the argument that, in principle, demand for such imports should be curbed through the pricing mechanism rather than through quantitative restrictions. However, I would caution that in many very low-income countries, the structure of demand is such that exclusive reliance on price-based approaches does not result in prompt and effective disincentives to socially divisive manifestations of conspicuous consumption.

My authorities fully recognize that the basis for a resumption of per capita income growth will not be effectively laid if, as happened between 1985 and 1987, the real level of imports is permitted to decline. Accordingly, a marked and sustained recovery of real output growth--to about 4 percent a year--equivalent to about 1 percent in per capita terms--will necessitate, as is shown in Table 6 of EBS/88/76, a substantial infusion of new lending, leading to a doubling in the level of external debt by 1992, while effecting a significant reduction in the annual debt service ratio. In line with their views expressed in Section V of EBD/88/118, the authorities strongly hope that the implementation of their growth-oriented adjustment program, supported with prompt financial assistance from the Fund and the World Bank, will in turn attract strong additional long-term financial support on concessional terms from other bilateral donors.

In conclusion, the authorities wish me to draw Directors' attention to the proposed strengthening of the underlying macro-economic policy stance by the implementation of substantial structural reforms in a number of areas. Such strengthening is designed to ensure a better allocation and use of domestic resources and to promote an increased role in the economy for the private sector, although the authorities remain quite concerned about its potential sociopolitical impact. They are committed to a gradual restoration of the signaling role of domestic prices to reflect true costs and scarcities. Also, as described on pages 19 and 25-27 of EBS/88/76, two-stage reform processes will be implemented in both the public enterprise and the financial sectors, with the principal objective of ensuring a more efficient allocation and use of resources by relying on more market-related mechanisms. The positive longer-term implications of this program of structural reform, which is being implemented with the active advice and assistance of the World

Bank, can hardly be overemphasized, although it must be recognized that its beneficial impact on the behavior of financial variables will take time to be manifested.

Extending his remarks, Mr. Abdallah said that Burundi's macroeconomic and structural adjustment amounted to such a strong program that the country would qualify easily for an enhanced structural adjustment arrangement, something that he hoped Directors would refer to in their interventions. Furthermore, the Government had adopted a useful innovation in the policy framework paper process by giving authority already both to the Managing Director and to the President of the World Bank to release the medium-term macroeconomic policy framework to all those organizations and donors that needed them, rather than following the standard procedure of obtaining the framework on a case-by-case basis.

Mr. de Groote said that he was satisfied with and strongly supported Burundi's comprehensive structural adjustment program. The authorities started implementing the program one month after the Board approved it in 1986, and he was especially grateful that recent steps had been taken along the same route with the current program. It was also gratifying to see the important joint contribution made by the staffs of the Fund and the World Bank to the success of the first program under the structural adjustment facility. The program was especially interesting, not only because it was the first one of its kind, but also as it laid out a model that was very much along the lines of what had been discussed in the preceding discussion on the policy framework paper. It laid the groundwork for sustainable economic growth over the medium and long term, and one could very well envisage it extending for a period of five to seven years--depending on the need--as was suggested by some Directors during the discussion on the policy framework paper. The program was based essentially on a greater reliance on market forces and on an outward reorientation of the economy while working simultaneously toward securing a viable external financial position--a remarkable combination of objectives.

The basic goals of the program included an interesting combination of demand-management and structural objectives, Mr. de Groote continued, such as the most important goal--in a country that had a very low per capita income--of obtaining a real growth rate fast enough to raise real per capita income, in addition to reducing the inflation rate, improving the balance of payments, and securing financial stability. The program attempted to reconcile those demand-management and structural objectives by using a combination of instruments, such as a comprehensive import liberalization program--which was a courageous measure for the authorities to undertake--and through the implementation of external debt management measures, the promotion of private sector initiatives and a related revision of the investment code, a pricing policy encouraging better resource allocation, more efficient public resource management, and a strengthening

of the public finances. All these measures were essential components of a comprehensive program of the type that should be followed by countries applying for a structural adjustment arrangement.

The positive effects of the program were obviously visible already, Mr. de Groote noted: domestic competition had increased, export-oriented activities had been encouraged, broad financial discipline had been maintained, and the competitiveness of Burundi's exports had improved. Of course, the program had suffered serious damage from the downturn in international coffee prices and the general deterioration in the terms of trade in 1987, which had adversely affected the balance of payments, the public finances, and the efforts to achieve monetary objectives. However, it was important to stress that the Government, or the program itself, were not responsible for the slippages, a view that the staff seemed to share. Burundi was a typical example of how developing countries implementing growth-oriented adjustment programs needed to have sufficient support to resist exogenous shocks.

The authorities' determination to continue implementing the adjustment program despite the adverse circumstances was welcome, Mr. de Groote remarked. The measures aimed at continuing an appropriate and realistic exchange rate policy involving the periodic and discrete adjustment of the rate, and the commitment to continue the liberalization of import and exchange controls were especially noteworthy. Other important aims that should be supported were the rehabilitation of the coffee marketing agency and the strengthening of small and medium-scale industries. Moreover, the earlier steps taken by the authorities in the monetary and credit sectors to reduce the recourse to commercial bank credits had allowed the authorities to allocate a sufficient amount of credit to the private sector and to design measures to improve that sector's efficiency.

Burundi's long-term economic success depended critically on having an effective population policy, improving the functioning of the labor market, good management of natural resources, and improving human resources by expanding education and health programs, Mr. de Groote pointed out. Those areas could perhaps have received more attention from the authorities themselves and from the World Bank. The Burundi program was typical in the sense that it was somewhat biased in favor of standard Fund measures and had relatively few Bank-designed ingredients, owing not to an invasion of the Bank's area of competence by the Fund staff, but to the lack of adequate input from the authorities and perhaps from the Bank staff. For the program to be labeled correctly as a structural one, the authorities and the Bank staff would have to have more input into it. The danger was that if demand-management measures were stressed too much, those measures might become ineffective over time if they were not supported by an appropriate structural framework.

Overall, the program deserved the support of donors, Mr. de Groote concluded. He was sure that the authorities' very courageous efforts

would receive timely support from donors and other member countries, and he hoped that their efforts would be aided by favorable exogenous conditions, and if not, that the Fund would have sufficient means to better protect the country from external shocks.

Mr. Rieffel made the following statement:

I remember well my enthusiasm when I reviewed Burundi's first annual structural adjustment arrangement in the summer of 1986. This was, of course, the first such arrangement to be submitted to the Board and was therefore our first opportunity to see a policy framework paper.

Since then, there has perhaps been more improvement in the quality of policy framework papers than in the quality of Burundi's economic performance. In particular, I regret that Burundi was not able to reach agreement with the Fund staff on a second annual structural adjustment arrangement until a few weeks ago. The delay was apparently due to difficulties on the part of the authorities in adjusting their policies to the sharp deterioration in the terms of trade in 1987, and not to any complications between the staffs of the Fund and the World Bank with respect to their approach to policy discussions with the authorities.

In any event, I am favorably impressed by Burundi's program for 1988, and believe that there are more opportunities for overperformance in this program than in the program that was supported by the first annual structural adjustment arrangement. In this connection, it is also worth noting that the first annual structural adjustment arrangement was supplemented by a stand-by arrangement, whereas the second one is not. I take this as a sign of the confidence that has developed in the policy framework paper as an instrument for promoting growth and balance of payments adjustment in a medium-term context.

The policy matrix provided with the updated policy framework paper is a distinct improvement over others, because of the way in which it distinguishes between actions already taken and actions to be taken. The matrix would be even more useful if it highlighted the changes that were made to the matrix provided in the original staff paper, and noted which measures had been adopted on schedule and which had been delayed. In addition, the matrix would be more enlightening if it noted which World Bank credits supported specific measures, rather than lumping all the Bank credits together.

More seriously, I have major problems with the presentation of an "alternative scenario" in this policy framework paper. In general, it is not appropriate to present alternative scenarios in policy framework papers, and I see no basis for making an

exception in the case of Burundi. One problem is that there are many possible alternative scenarios; by picking one in which the only change is more external financing, the balance of the paper is shifted away from policy reform and toward financing.

A second problem with the inclusion of alternative scenarios is that they detract from the effort to reconcile different views between the Fund and the World Bank. It is extremely important to reconcile these differences to arrive at a program that is internally consistent.

A third problem is that alternative scenarios can lead to expectations that are difficult to satisfy. I suspect that there will be a natural tendency, in the case of Burundi, for elements of the Government to formulate plans on the basis of the scenario with more financing. Also, in contacts with potential donors, the second scenario will inevitably be used to focus attention on levels of assistance rather than on the quality of assistance.

If it appears useful in a specific country to consider alternative scenarios, this should be done in other staff papers, such as an Article IV consultation report, or a report for a consultative group meeting. It is in the interest of all to keep the policy framework paper simple and narrowly focused on a single path of adjustment that is feasible and credible.

Other than the above considerations, I am quite satisfied with Burundi's updated policy framework paper, although a few additional points should be made. While exports are projected to grow at twice the rate of imports--8 percent a year in comparison with 4 percent--imports as a percent of GDP in 1987 were almost two and one half times the export ratio. I wonder whether this pace of trade adjustment will lead to a viable payments position by the mid-1990s. At the same time, I question the need for four months' coverage of imports for reserves. It seems that three months would be sufficient, given Burundi's circumstances, and I believe that the objective in the original policy framework paper was three months' coverage. Similarly, the projections seem to imply a very high per capita level of foreign assistance, which might not be sustainable during the next five years. Finally, the policy framework paper implies a greater role for the private sector in the economy of Burundi. It is not clear, however, to what extent the private sector can respond to the various macroeconomic and structural reforms, especially when foreign investment is not expected to exceed SDR 2 million a year during the next five years.

The measures that were outlined in the 1988 program appear to be quite substantial. In particular, the authorities should be commended for their efforts to rationalize the parastatal

sector and to remove controls in the financial sector. It was also gratifying to see that the Finance Ministry will have to approve all exemptions from customs duty payments.

My only criticism of the program is that the benchmark relating to the placement of experts in the Burundi Coffee Company seems to be too narrow. I would have preferred to see a benchmark relating to the public expenditure program, or perhaps to parastatal reform.

Mr. Abdallah has asked for Directors' views on the possibility of an enhanced structural adjustment arrangement for Burundi. We would like to reflect on this further, but my immediate reaction is that the authorities should resist the temptation to view the enhanced structural adjustment facility as just another source of concessional aid and should discuss with the staff the possibility of converting to an enhanced structural adjustment arrangement in 1989, if this can be done in a way that contributes to a reduced reliance on exceptional financing.

The program seems to represent the best opportunity for reaching a sustainable growth path over the medium term, and I support the proposed decisions.

Mr. Enoch said that he welcomed Burundi's resumption of the adjustment program under the structural adjustment arrangement, which had been interrupted in 1987. The second-year arrangement included a wide range of significant actions, including important fiscal measures, particularly reforms to broaden the tax base away from its dependence on coffee exports and to improve revenue collection, and the sizable increase in discretionary revenues equivalent to some 3 1/4 percent of GDP. The proposals for parastatal reform and the objective of import liberalization were also welcome. The program's credibility had been considerably enhanced by the important prior actions that had been taken by the authorities, notably the adjustment of the exchange rate for the real appreciation that had occurred since the breakdown of the first annual arrangement and the correction of public utility tariffs. Moreover, the ambitious credit and monetary policies aiming for the complete market determination of all lending and deposit rates by mid-1989 were particularly impressive. A liberalized financial sector, together with continued exchange rate flexibility, should greatly facilitate the reallocation of resources into new industries, which were vital to the medium-term future of the Burundi economy.

The strength of the proposed reforms was very necessary in view of the difficult situation of Burundi, Mr. Enoch continued. Imbalances were large, and the economy remained highly vulnerable to external developments, particularly through its dependence on coffee exports, its tenuous transport links, and the volatility of its large debt service burden. Burundi also had to cope with remorseless demographic pressures, and it needed to catch

up for almost a year of lost time following the breakdown of the first-year arrangement. The precariousness of the situation raised doubts in his mind about whether the proposed pace of adjustment fully matched the urgency of the situation, especially whether the growth objectives were feasible given the size of the problems and the available resources. Little improvement was envisaged in the current account by 1991 and, indeed, the trade deficit would widen in the medium term, which was particularly disturbing in view of Burundi's external vulnerability.

In that connection, although a number of chairs had questioned whether alternative scenarios should be included in the policy framework paper, Mr. Enoch noted, in the current context especially, he did not mind seeing more than one scenario if the optimistic faster growth option was perhaps counterbalanced by a more pessimistic scenario.

The relatively limited pace of external strengthening seemed to partly reflect the relaxation of the fiscal restraint effort after 1989--as reflected in the decline in the fiscal revenue/GDP ratio--Mr. Enoch considered. There was also apparently some vagueness about the precise contribution of reforms in areas like rationalizing civil service employment and in parastatal reform. He hoped that some of the budget gaps would be filled after the completion of the public expenditure review; nonetheless, he was still concerned that the fiscal and external accounts, which continued to be weak, could jeopardize the very commendable monetary and credit policy objectives or be jeopardized by the removal of external restrictions.

The opaqueness of the exchange rate mechanism, or the system of discretionary adjustments and reviews, seemed curiously at odds with the proposals to liberalize credit and monetary policies, Mr. Enoch noted. Moreover, the mechanism was too easily interrupted, as it had been in much of 1987. He wondered whether the authorities should not consider introducing a more precise and transparent mechanism, such as an interbank market, the period of the structural adjustment arrangement.

The structural adjustment arrangement request set out a number of administrative improvements that would reinforce the adjustment effort, Mr. Enoch remarked, although it was difficult to tell whether the policy process was at present sufficiently flexible to avoid a recurrence of the situation that occurred in 1987, when the authorities had been unable to adapt policy to a sudden deterioration in circumstances. It was not apparent from the staff paper how much thought had been given to contingent actions; such flexibility was particularly important in view of Burundi's exposure to external factors.

Given the risks that Burundi confronted, a possible conversion from the existing structural adjustment arrangement to the enhanced version would require a somewhat faster pace of adjustment, particularly of fiscal policy, Mr. Enoch observed. More rapid adjustment should be feasible with the additional resources that would be available under the enhanced structural adjustment arrangement. The prime requirement in considering a

possible conversion would be the clear prospect of medium-term balance of payments viability, including the complete elimination of current account restrictions within the program period. Moreover, in view of the extended interruption after the first-year arrangement under the structural adjustment facility, the possibility of converting to the enhanced version of that arrangement should follow the establishment of a successful record of sustained adjustment under the second-year arrangement.

A number of procedural points should be made, Mr. Enoch considered. To repeat a request that he had made in the past, it would be invaluable to have some idea of the weight of the parastatals that had been targeted for reform, both in the economy and in terms of their burden on the Government. It was always interesting to have some idea of the total number of parastatal corporations and their aggregate weight in the economy. Some idea of the importance of price and import liberalization measures should also be included as a standard feature of the policy framework papers.

He wished to reiterate that medium-term analyses should pay appropriate attention to the regional context of countries, Mr. Enoch concluded. That need was especially true for countries like Burundi, which had small open economies, were crucially dependent on a regional transport system, and were seeking to diversify exports within a regional market. As Mr. Abdallah had noted in his opening statement, successful export diversification was likely to depend quite heavily on the relaxation of the restrictions that prevailed in the Preferential Trade Area. It was therefore regrettable that no attention had been given in the staff papers to the developments in exchange restrictions in Burundi's partner countries.

Mr. Kleine said that despite the commendable progress that had been achieved in several areas, overall performance under the first annual arrangement under the structural adjustment facility had not been quite satisfactory. Of course, external developments were at the core of the program's difficulties, but it remained worrisome that the authorities had made no convincing efforts to offset the adverse impact of the external shocks on the fiscal position by adopting timely measures to increase fiscal revenues and to contain fiscal expenditures. Revenue collection had been below target, while some expenditure categories, including outlays for wages and salaries, had been above the targeted levels; in particular, the continuation of civil service recruitment had increased the Government's wage bill. It was also a cause for concern that a core element of the program, flexible exchange rate management, was interrupted in 1987. Under those circumstances, the better than expected growth performance and the better than envisaged outturn of the domestic inflation rate offered little consolation, as they seemed unlikely to be sustainable over the medium term.

Given Burundi's performance, the request for a second-year arrangement should be approached with some reservations, Mr. Kleine continued; after all, it had been agreed that requests for additional arrangements had to take into account experience under preceding arrangements. But in view of

the new Government's far-reaching commitments and the very commendable prior actions that it had taken, he supported Burundi's request for the second-year arrangement.

It appeared that the recommendations in the summing up for the 1987 Article IV consultation with Burundi remained valid, Mr. Kleine pointed out. There was a particularly urgent need to increase revenue, to prevent the Government from exceeding the programmed levels for recurrent fiscal expenditure, and to avoid accumulating new domestic arrears. Of equal importance were strengthened efforts to reform the public enterprise sector and to pursue a genuinely flexible exchange rate policy. It was gratifying to note that those specific concerns would be met under the second-year arrangement.

With respect to the issue of whether to include two scenarios in Burundi's policy framework paper, his chair's position had been expressed by Mr. Goos in the just completed Board discussion on policy framework papers, Mr. Kleine concluded. Moreover, he agreed with Mr. Enoch's views on the possible conversion of the structural adjustment arrangement into an enhanced structural adjustment arrangement. He supported the proposed decisions.

Mr. Fuleihan made the following statement:

In 1986, the authorities undertook a comprehensive medium-term adjustment program that was supported by the Fund. Although the authorities implemented most of the policy measures included in the program under the first annual arrangement, the external, fiscal, and monetary targets were not met. The slippages were due mainly to the drastic deterioration in coffee prices in 1987, which led to a 40 percent reduction in Burundi's terms of trade. Policy slippages in the tax reform program and the authorities' inability to adapt their policies to a changing external environment were factors that further derailed the adjustment effort.

As coffee accounts for 85 percent of Burundi's export receipts and a major share of tax revenues, the main challenge is clearly to diversify both exports and revenue sources. Export diversification and, more specifically, the promotion of non-traditional exports can be achieved by encouraging the private sector; hence, the adoption of a realistic exchange rate and the liberalization of the trade regime is appropriate. In addition, the authorities could provide the private sector with investment incentives and opportunities through the implementation of a financial sector reform program that relies on the market to determine credit expansion and resource allocation.

To diversify their sources of revenue, the authorities may find it helpful to improve the tax structure by enhancing tax elasticity, widening the tax base, and reforming the import

tariff code. Moreover, the implementation of a privatization program could reduce the drain on government resources and increase economic efficiency, which would further enhance private sector participation and that of the remaining viable parastatals. In this context, it is important to reform the Burundi Coffee Company and to increase its marketing abilities, especially since it was unable to profit from the exceptionally high international coffee prices in 1986. Indeed, the authorities' updated medium-term objectives and their program for 1988 promise to do just that. In that connection, I also welcome Mr. Abdallah's assurances in his opening statement.

Looking ahead, the medium-term outlook for the economy raises some concern: the balance of payments will continue to be under severe pressure in the medium term, since the deterioration in the terms of trade is not likely to be significantly reversed. Moreover, Burundi's continued dependence on coffee exports highlights its sensitivity to international price fluctuations and thus makes it imperative that the authorities stand ready to undertake additional adjustment measures as the need arises.

In addition, despite the fact that the debt service ratio is projected to decline from 44 percent in 1987 to 30 percent in 1991, it will still constitute a major burden. This is further underlined by the debt profile, as a major fraction of debt is owed to multilateral organizations and is not subject to rescheduling. The authorities, therefore, need to maintain a prudent borrowing and debt management policy. It is encouraging that the authorities have recognized the dimensions of this problem and have strengthened the powers of the debt committee.

Burundi's adjustment efforts have been derailed largely because of external circumstances; nonetheless, the authorities have responded by strengthening their adjustment efforts in 1988. They have shown a clear commitment to reform by adopting several prior actions and by professing their willingness to incorporate further measures if needed. Therefore, I support the proposed decisions.

Mr. Toé stated that he supported the proposed decisions.

The staff representative from the African Department said that in assessing the likely capital inflow, the staff had been very careful in coordinating its estimates with those of the World Bank. As had been indicated in the staff paper, most of the resources that were retained in the program--at least for 1988--were based on existing commitments, and, therefore, the staff did not believe that the estimates were optimistic.

The reserve target, equivalent to four months of imports, was not too high, the staff representative continued; considering Burundi's landlocked location and the volatility of its coffee export earnings, the Government's desire to strengthen the reserve cushion to meet any contingencies was justified. Of course, as the program evolved, the reserve target would have to be reviewed and adapted if circumstances called for it; for example, in 1988, the gross reserve target had been scaled down because the authorities felt that the likely developments in the balance of payments, including external resources, would not warrant the maintenance of the original targets. There was considerable flexibility in setting the reserve targets.

The authorities had requested technical assistance from the Fund to survey new revenue sources to diversify the revenue base away from coffee exports, the staff representative pointed out. Some of those measures were being implemented in 1988, but most would be put into place progressively in the period 1988-90. The Government was fully committed to two fiscal objectives, namely, to increase noncoffee revenue by the equivalent of 2 percentage points of GDP in the period 1988-91--which the staff viewed as a major effort by the authorities--and to lower the ratio of the overall fiscal deficit to GDP to 5 percent, which the staff thought was the sustainable medium-term level.

The Government was devoting some attention to the issue of whether a more transparent exchange rate management mechanism was warranted, instead of the gradual periodic adjustment and review that characterized current policy, the staff representative noted. The staff hoped that by the time it came back to the Board for the third-year arrangement under the structural adjustment facility, or to a possible enhanced structural adjustment program, it would have come to some agreement with the Government on an exchange rate management mechanism that would be more automatic than the one that was currently proposed.

In Burundi, there were about 60 parastatal enterprises, the staff representative observed, and by the time that the joint Fund/Bank effort under the structural adjustment arrangement and the structural adjustment loan had evolved, probably close to half of those corporations would have been closed down, reformed, rehabilitated, or strengthened. The reform of the parastatal sector was a very sizable and important factor in Burundi's prospects for growth, which the World Bank's structural adjustment loan was devoted strongly to achieving.

The Government was fully committed to price and import liberalization, the staff representative added. Further measures were being put in place in 1988, and it was expected that those actions would be continued in 1989 and beyond.

The measures that the authorities were implementing were, in a sense, preparing Burundi to take advantage of the 14-member free market arrangement in the so-called ZEP (Zone d'Echanges Préférentiels) countries in the area, the staff representative from the African Department concluded.

Burundi's liberalization efforts and its pricing policy would help it to gain a strong foothold in those markets. In that connection, Burundi's main vulnerability--which the staff had referred to in the consultation reports in December 1987--was its export situation, particularly in relation to its transportation link with Dar es Salaam. The latter issue had been raised, and it had been agreed that, with the World Bank's assistance, some action would be taken.

The staff representative from the Exchange and Trade Relations Department said that no market-determined exchange rate mechanism had been agreed to under the present program in Burundi, although there was a flexible mechanism taking into account the real effective exchange rate and all the other factors enabling one to assess a country's balance of payments position--whether it was moving in the desired direction, for instance, and whether the liberalization program was straining the balance of payments. In effect, there were agreed month-to-month minimum exchange rate targets, and exchange rate policy had also been subject to periodic reviews; the last such review took place during the Article IV discussions with the Fund.

Mr. de Groote asked whether the staff believed that the system of stable and adjustable exchange rates was preferable to a market-determined solution.

The staff representative from the African Department replied that the Government was examining the exchange rate issue, and that the staff was prepared to conduct a study with the authorities of the available options.

The staff representative from the Exchange and Trade Relations Department said that Directors' comments about whether Burundi should have an enhanced structural adjustment arrangement had been noted. It was particularly important to take into account a number of cautionary factors in deciding on a possible timetable for converting the existing arrangement into an enhanced structural adjustment arrangement, namely, the completion of the public expenditure review designed to integrate the public expenditure program into a proper macroscenario, progress with the new system of debt monitoring that was being introduced, and the still to be completed studies on civil service reform, all of which would obviously be necessary to provide a basis and guidelines for later policy reforms.

In the case of Burundi it was very important to integrate any second or alternative scenario into a budgetary framework, the staff representative from the Exchange and Trade Relations Department concluded. The staff had to consider the recurrent cost implications of all projects, and, of course, their medium-term balance of payments implications, the full debt scenarios, and the impact on the trade balance. The present program had been developed on the baseline scenario with those considerations in mind, and that baseline scenario would need to be adapted to changing circumstances at the time of the next review.

Mr. Abdallah said that he agreed with Mr. Enoch that the landlocked situation, and hence, the transportation constraints of Burundi, Uganda, and other similarly placed countries was a very important factor. Burundi had access to the ocean only through a southern transport route to Dar es Salaam, and through a northern route that went via Uganda to Kenya, which the European Investment Bank and European Community were supporting financially. There was also a third route along the Kagera River and through Lake Victoria, which, although it was an old route, was being developed.

Beyond the transportation problem was the more important issue of the balance of payments situation of neighboring countries, Mr. Abdallah continued. Uganda, Tanzania, and other countries could be ready markets for Burundi's products, but as there was a serious payments problem in the preferential trade area--with two or three countries being in permanent creditor positions and a number of countries being in permanent deficit positions--one had to be realistic about the markets that Burundi could seek. It was too much to expect that Burundi could transport all its non-traditional goods across Tanzania, Uganda, or Kenya and then export them overseas at a profit.

As he had emphasized during the previous Article IV discussion of Burundi, the Fund, perhaps in collaboration with the World Bank, should take a very close look at the countries in the region, Mr. Abdallah concluded. Such an examination was particularly necessary as part of those countries' problems arose from transportation difficulties; for instance, much of Uganda's imports and exports were stuck in either Mombasa or Dar es Salaam.

The Executive Board then took the following decisions:

Structural Adjustment Facility - Second Annual Arrangement

1. The Government of Burundi has requested the second annual arrangement under the structural adjustment facility.
2. The Fund has appraised the progress of Burundi in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/88/118).
3. The Fund approves the arrangement set forth in EBS/88/76, Supplement 1.

Decision No. 8865-(88/70), adopted
May 4, 1988

Exchange System

In the circumstances of Burundi, the Fund approves the restriction on foreign remittances of profits, dividends, and

other income pertaining to international transactions until the completion of the next Article IV consultation with Burundi or December 31, 1988, whichever is earlier.

Decision No. 8866-(88/70), adopted
May 4, 1988

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/69 (5/4/88) and EBM/88/70 (5/4/88).

3. ALGERIA - TECHNICAL ASSISTANCE

In response to a request from the Algerian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/121 (4/29/88).

Adopted May 4, 1988

4. POLISH PEOPLE'S REPUBLIC - TECHNICAL ASSISTANCE

In response to a request from the Polish authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/122 (4/29/88).

Adopted May 4, 1988

5. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/88/109 (4/29/88) is approved.

APPROVED: December 14, 1988

JOSEPH W. LANG, JR.
Acting Secretary

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