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August 5, 1988

To: Members of the Executive Board

From: The Acting Secretary

Subject: Final Minutes of Executive Board Meeting 87/154

The following corrections have been made in the final minutes of EBM/87/154 (11/6/87):

Page 1, last line : for "1987...Page 35"
read "1987...Page 36"

Page 2, heading: for "EBM/87/159" read "EBM/87/154"

line 1: for "Argentina... Page 18"
read "Argentina... Page 40"

line 2: for "Cape Verde...Page 23"
read "Cape Verde...Page 41"

Page 35, following 1st full para: Insert text of three Executive Board Decisions which were inadvertently omitted.

Items 3 through 5 on pages 35 through 39 now appear on pages 36 through 41.

Corrected and new pages are attached.

Att: (9)

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Department Heads

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/154

3:00 p.m., November 6, 1987

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

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	Jiang H.
	E. L. Walker, Temporary
	G. Seyler, Temporary
	M. Hepp, Temporary
	A. M. Othman
	S. K. Fayyad, Temporary
	B. Goos
J. E. Ismael	
	L. M. Piantini, Temporary
	C. Enoch
	M. Fogelholm
	W. N. Engert, Temporary
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
	V. J. Fernández, Temporary
	V. Rousset, Temporary
G. A. Posthumus	G. P. J. Hogeweg
	I. Sliper, Temporary
G. Salehkhou	
A. K. Sengupta	L. E. N. Fernando
	M. Sugita
	F. Di Mauro, Temporary

L. Van Houtven, Secretary and Counsellor
J. K. Bungay, Assistant
S. Woolls, Assistant

Corrected: 8/5/88

Also Present

IBRD: R. V. Key, V. Nehru, Africa Regional Office. African Department: A. D. Ouattara, Counsellor and Director; J. Artus, D. T. S. Ballali, E. A. Calamitsis, I. A. H. Diogo, P. Dhonte, Y. Fassassi, C. A. François, P. Mylonas, E. Sacerdoti, R. L. Sharer, R. H. van Til, R. C. Williams. Asian Department: R. J. Hides, E. A. Milne. Central Banking Department: H. A. Snoek. European Department: C. Liuksila, K.-W. Riechel, B. M. Traa. Exchange and Trade Relaions Department: S. J. Anjaria, G. Bélanger, E. Brau, L. Hansen, H. B. Junz, P. Leeahtam, M. H. Rodlauer, P. Thomsen. External Relations Department: N. Worth. Fiscal Affairs Department: S. K. Chand. IMF Institute: O. B. Makalou. Legal Department: H. Elizalde, J. M. Ogoola. Treasurer's Department: D. V. Pritchett. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: A. R. Ismael, A. Ouanes, P. D. Péroz, G. Pineau, I. Puro, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: N. Adachi, F. E. R. Alfiler, R. Comotto, S. Guribye, C. L. Haynes, S. King, M. A. Kyhlberg, V. K. Malhotra, D. V. Nhien, S. Rebecchini, A. Rieffel, S. Rouai, C. C. A. van den Berg, H. van der Burg, Wang X., R. Wenzel, D. A. Woodward, I. Zaidi.

1. GHANA - EXTENDED ARRANGEMENT AND STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors resumed their consideration of the staff paper on Ghana's requests for an extended arrangement and for an arrangement under the structural adjustment facility (EBS/87/207, 10/2/87; and Sup. 1, 10/16/87), together with a policy framework paper (EBD/87/247, 9/30/87).

Mr. Sugita made the following statement:

Like others, I am pleased to note the further progress in Ghana's adjustment efforts during the past year and the recent favorable economic response to such efforts. Liberalization of the trade and exchange system was continued, and agricultural incentives were further strengthened. After a resurgence in inflation, fiscal and monetary policies were tightened. The authorities' planned reform of the tax structure and strengthening of tax administration will not only be instrumental in reducing the overall fiscal deficit but will also contribute to an increase in the requisite savings. While the performance on the inflation front has not been as favorable as expected, the underlying economic expansion can be said to be continuing, when the effect of the weather on agricultural production is taken into account. An improvement in the balance of payments has allowed the authorities to reduce external arrears, and this, coupled with good performance on the domestic front, has had a particularly salutary effect on the creditors' perception of the creditworthiness of Ghana.

In order to put this recent recovery on a firm footing and pave the way for further development, however, Ghana has to tackle a number of structural as well as financial problems, which are well recognized by the authorities and are dealt with in great detail in the welldesigned program before us. Given the strong determination shown by the authorities in recent years, I have no difficulty in supporting the proposals for an extended arrangement and an arrangement under the structural adjustment facility. Nevertheless, I must stress a few points that are essential for the achievement of the program objectives. First, the recent price acceleration is exceedingly worrying; accordingly, other measures, perhaps somewhat stronger than those envisaged in the program, may be required to bring down the rate of inflation to a level consistent with smooth implementation of the program. Second, it is important to recognize that the success of the program hinges critically upon domestic resource mobilization, without which the investment needed for high economic growth will not be realized. Therefore, an all-out attack is called for on various fronts, including government revenue and expenditures, parastatals, the financial system, and interest rates. A slippage in one area could easily result in a collapse of the program. Finally, it is important to ensure that the brightened prospect for the future not be translated into a loosening of the incomes policy today. Improvement in real income will follow perseverance with adjustment efforts--not vice versa.

Mr. Fernández made the following statement:

This chair supports the proposed decisions. We are glad to observe that the authorities are willing to maintain and reinforce their collaboration with the Fund and the World Bank through both extended and structural adjustment arrangements. We congratulate the authorities for the recent performance of the economy and for the achievement of the macroeconomic objectives of the program for 1986. This performance is mainly the result of a number of economic measures, most of them in the right direction.

Significant progress in financial reforms has been made in recent years, but the financial system remains weak. Further steps should be implemented to achieve market-determined interest rates in line with the proposed measures for 1988. An expansion in the intermediation role of commercial banks is also advisable. At the same time, it is necessary to strengthen the financial position of banking institutions. These reforms will facilitate the implementation of sound financial policies aimed at controlling inflationary expectations and balance of payments developments.

We also welcome the progress made in exchange and trade liberalization, as well as in pricing policies. We very much agree with these movements toward the market-oriented allocation of resources. In particular, we deem desirable the unification of exchange rates and the achievement of complete liberalization of current account transactions by the end of June 1990, as intended by the authorities under the program for 1987-90.

We are concerned, however, about the external vulnerability of the economy. Some of these dangers are not under the authorities' control and are related to the international environment and commodity prices. If the authorities continue to put into practice sound domestic adjustment policies, external financing should be available to support Ghana's adjustment and reform efforts.

Turning now to other structural reforms, we believe that renewed efforts should be devoted to improve tax administration and expenditure control. Moreover, we welcome the tax reforms focused not only on raising revenues but also on the removal of distortions in order to increase efficiency.

Government expenditures should be made according to standard cost-benefit analysis. In particular, progress made in the implementation of public investment expenditures should continue within the public investment program framework agreed with the World Bank and endorsed by donors at the meeting of the Consultative Group for Ghana in May 1987. An extension of the present public investment program to cover the period 1988-90 is most desirable.

We also support the ongoing rationalization in the management of public enterprises. These reforms imply that state enterprises should take more into account market signals and productivity patterns in the development of their activities.

To conclude, we note with satisfaction the staff's optimism about the positive attitude of the authorities toward the consistent implementation of their medium-term economic program. We commend the authorities for their useful collaboration with the Fund and the World Bank and believe that maintenance of this relationship will be in Ghana's best interest. Finally, we endorse the staff's point of view on the importance of controlling inflation and strictly observing the timetable of the structural reforms.

Mr. Sengupta made the following statement:

We are in general agreement with the thrust of the staff appraisal, and we support the proposed decisions in respect of the requests for both the extended and structural adjustment arrangements. However, a few points are worth careful consideration, because this is the first request for an extended arrangement in more than two years.

Ghana is one of the few countries seeking Fund assistance to address medium-term structural and financial problems, after having successfully completed three stand-by arrangements in the immediate past. As set out, the program is strong and follows practically every policy that the Fund usually prescribes, and thus it should be able to achieve the medium-term objectives. The policy framework behind the program is very comprehensive; although the detailed time frame for the policies looks too much like a straitjacket, the authorities have accepted it, and I will not pursue the matter. Ghana has agreed to adopt a number of important measures. There will be a retrenchment of civil service staff by 45,000 during the years 1987-89. The authorities intend to liberalize completely current account transactions by end-June 1990, and to pursue a flexible exchange rate policy. Under that policy, the auction rate since June 1987 has been ₵ 175 per U.S. dollar, compared with ₵ 90 in January 1986 and ₵ 2.75 in 1983. Thirty state enterprises have already been identified for outright sale, conversion to joint ventures, or liquidation. Producer prices for cocoa will increase substantially from 25 percent of the world market price--₵ 85,500 per ton--in 1986/87 to 40 percent--₵ 150,000 per ton--in 1987/88, and are expected to reach 55 percent for the 1989/90 crop year. Growth in government expenditure is expected to fall from 44 percent in 1987 to 13 percent in 1990. According to the thinking of the Fund, Ghana's adoption of the above measures should solve its balance of payments problems and result in external payments viability with sustainable growth. I only hope that we are not being too ambitious.

The main issue is not the strength or adequacy of the program as such, but whether it is based on an empirical assessment of the real constraints of the economy and the international support forthcoming to help Ghana implement the program. The program emphasizes the speed and strength of adjustment rather than the feasibility of the financing. This emphasis can be seen from the fact that the ratio of gross investment to income is envisaged to rise from 12 percent in 1986 to about 18 percent in 1990, and that the ratio of domestic savings to income ratio is expected to increase from about 10 percent in 1986 to slightly over 15 percent in 1990. The increases in the 1986 estimates themselves were very substantial--almost 50-100 percent higher than the previous trend. Has the staff examined whether this is just a one-year random event, or instead an indication of a substantial change? In any case, the increases in these ratios projected for the program period are too large; given the 5 percent annual average growth rate of real GDP over the medium term, they imply a very high order of incremental savings in relation to income. Additional revenue mobilization, state enterprise reforms, as well as financial sector reforms and the maintenance of flexible interest rates undoubtedly will help improve the savings ratio, but I wonder whether it really will do so to this extent within a period of three years. I have a suspicion that the staff too has at times doubted this possibility; otherwise, it would not have suggested "an appropriate 'rolling' public investment program" during the period 1988-90, or discussed the core investment projects to protect public investment strategy from possible funding constraints. The public investment program is crucial for achieving the growth targets and is based mainly on external assistance. The critical point is that for the success of the medium-term program, as the staff paper observes, public investment will have to rise from about 6 percent of GDP in 1986 to 10 percent in 1990. However, if that is not possible because of funding constraints, then following its own logic, the staff should have indicated what the growth results would be if only the core projects were implemented.

In the absence of details on private sector investments, it is difficult to know how well the private sector would respond to the fiscal incentives--provided by the envisaged reductions in the personal income and corporate taxes and by the investment code modifications--and to price liberalization, at a time when a flexible interest rate policy with restricted credit expansion of the program might raise the interest rates substantially.

I raise these issues because if the extended arrangement is not to be treated as three one-year stand-by arrangements, the growth implications for achieving a viable balance of payments should be clearly brought out. The program envisages a growth rate of 4-6 percent a year, which is supposed to be achieved through the assumed large increase in the rate of investment. Accordingly, if the path of the rate of investment is not secured, the growth objectives also remain insecure. If investments do not rise to the envisaged extent, is it possible for us to think of some contingency mechanisms to protect the growth rate from falling below the targeted level? In this context, I refer to the interesting proposal made by the Group of Twenty-Four in its recent report. If domestic savings do not increase at the rapid rate assumed in the program, the only way to sustain the targeted investment to achieve the expected growth rate is through increased external financing. I wonder whether it is possible now for the Fund to incorporate this contingency mechanism element, which might imply larger Fund support, in the extended arrangement. I believe that this is a challenge worth accepting, especially since the Fund's exposure in Ghana will decline gradually by the end of the program period.

Furthermore, in the alternative scenarios for the balance of payments over the medium term, the staff indicates that if the export volume growth were less than the program projection, that development would entail a rapidly increasing and unsustainable financing gap. Such a development is clearly beyond the control of the authorities. It would indeed have been useful if the staff had introduced a contingency mechanism to indicate what measures should be taken and how additional finance could be mobilized to support the program objectives.

The proposed replacement of the current export tax by an agricultural income tax will not be easy to implement, given the contraction of administrative expenditures and the large retrenchment of personnel. We welcome the proposal of the authorities to examine this proposal carefully.

On the divestiture program, I note the offer for sale of five state enterprises and the initiation of liquidation proceedings for another five state enterprises by December 1987. I would be interested to know the implications of such sales, in terms of the budget and credit expansion. There is also the larger question as to why this was regarded as a structural benchmark for the purpose of monitoring progress under the structural adjustment arrangement. What would be the implications on both those scores in case the sale offers are not accepted.

I have already hinted at the influence of interest rates on domestic private investment activity. The removal of the ceiling on the lending rate means that investors will have to weigh carefully the cost of credit against the rate of return of the enterprises and business. However, given the limited growth in consumption, it is not clear whether the rates of return could be expected to be large enough to provide incentives to invest.

The sharp curtailment of domestic credit for the rest of the economy in the second half of 1987 is regarded as temporary, but the data show that in general, the availability of credit to this segment of the economy during the program period will be extremely limited and tight. While such an outcome may have a salutary effect on prices, as indicated by the staff in Supplement 1 to EBS/87/207, it would have serious consequences on the level of output. Has the staff made any assessment of this factor or has it just gone by the usual monetarist assumption that output is invariant to the level of credit?

The staff papers give few details on the relationship between the exchange rate and the inflation rate. In Supplement 1 to EBS/87/207, Chart 1 shows that both nominal and real effective exchange rates have declined sharply since 1983, yet according to the information on page 20, there seems to be a gap between the official and parallel market rates. If further depreciation takes place, prices might rise faster than expected, and the terms of trade might deteriorate more. How does the staff project a sharp fall in the inflation rate, which has been about 30-35 percent in the past few years, to about 8 percent by 1990? Is this decline in the inflation rate a target or projection? If it is a projection, what are the variables considered in the model? If it is a target, what is the instrument by which it will be achieved?

Mr. Fogelholm made the following statement:

Like other speakers, I commend the authorities for their persistent adjustment efforts and the progress achieved to date under the Economic Recovery Program. In the medium term, very important adjustment problems still need to be solved. While I broadly agree with the staff's assessment of the economic situation and the policy measures required, and share earlier speakers' concerns about recent developments, I would like to provide some comments and raise a few questions with regard to the intended policies in the medium term. Like many other eveloping countries, Ghana is strongly dependent on the developments in the external environment. The sensitivity of the balance of payments situation to changes in the cocoa and petroleum prices is clearly illustrated in Table 8 of Supplement 1 to EBS/87/207. It would be interesting to hear from the staff whether there are any contingency plans in the event that the baseline scenario does not materialize.

Diversification of Ghanaian industry seems to be of utmost importance, in the light of Ghana's heavy reliance on world market prices. Moreover, if the adjustment efforts are to succeed in the longer perspective, there seems to be not only a need to rationalize producer incentives in cocoa production, but also to introduce incentives aimed at a revitalization of the manufacturing sector and a further strengthening of the industrial base. The progressive movement toward a realistic and flexible exchange rate system, the development of the financial market, as well as liberalization of trade, will undoubtedly contribute to such a development. However, it is also emphasized in the staff report that the current low productivity stems partly from insufficient support services. In the light of the measures presented, I have some doubts about the possibility of avoiding a situation in which the structural weaknesses within the country are hampering the gains to be generated by financial incentives. Staff comment on this situation would be helpful.

In the fiscal area, a tax reform geared toward improving domestic resource allocation is now in progress. I believe this to be very important, as it will increase the means and scope for restricting fiscal policy. In this connection, however, a question arises about the tax on petroleum products. Since the drop in oil prices, the specific excise duties levied on oil products have constituted a major contribution to government revenue, and according to plans, these duties will continue to be an important source of revenue. With regard to the need to encourage and develop internationally competitive industries, such a policy must rest on the assumption that competing industries in other countries are subject to similar tax policies, and I am not certain that this is the case.

After having successfully completed three stand-by arrangements in a row, Ghana is now requesting an extended arrangement, together with a structural adjustment arrangement. This approach seems both logical and appropriate, as it is quite clear that despite ambitious and sustained adjustment efforts, Ghana's deep-rooted economic problems cannot be solved in the short term. The choice of an extended arrangement instead of consecutive stand-by arrangements seems to be well founded, because in the extended arrangement greater stress is placed on structural and longer-term elements. In this connection, I share the view of Mr. Ouanes that a combination of these two arrangements is particularly beneficial. I am also of the opinion that approval of an extended arrangement requires the country in question to have its short-run, demand-management policies broadly in place; in my view, Ghana meets this criterion. Furthermore, the policy framework paper accompanying the request for a structural adjustment arrangement seems to be sufficiently comprehensive and specific in formulating the strategies and measures necessary under the program.

Finally, a more general remark. I do not believe that unfavorable developments under former extended arrangements should be allowed to affect our future decisions in this regard. The overall trend in the world economy and the persistent debt problem have forced the Fund to adopt successively measures that aim at correcting medium-term and structurally based problems. I hope that the experience gained from these developments will be instrumental in the creation of more realistic medium-term programs now than in the past. I support the proposed decisions.

Mr. Fayyad made the following statement:

Ghana's economic performance over the past few years has been quite impressive, and the authorities are to be commended for implementing a wide range of corrective structural and demand-management policy measures that have contributed to the improved performance. Most of the important policy objectives of the successive Fund-supported programs undertaken by the authorities were achieved, including the realization of healthy economic growth, a substantial improvement in the balance of payments position, and a reduction in the stock of outstanding external arrears. These achievements largely reflect a determined adjustment effort that, since the adoption of the Economic Recovery Program in 1983, has encompassed reforms in fiscal, monetary, exchange rate, and pricing policies, as well as important structural reforms aimed at effecting a fundamental reorientation of the economy.

The success of Ghana's adjustment effort thus far provides a basis for optimism that the economic recovery under way will be sustained in the medium term. It is to be emphasized, however, that achievement of that objective will be critically dependent on the authorities' perseverance in pursuing the appropriate mix of structural and financial policies outlined in the medium-term policy framework paper that they have prepared in collaboration with the staffs of the Fund and the World Bank. Despite the considerable gains that have already been achieved, the economy continues to be constrained by structural deficiencies, inflation is an ongoing source of concern, and the external debt burden remains heavy. In addition, the external payments position remains vulnerable to adverse external developments. Under these circumstances, the authorities did well to recognize the need to strengthen their adjustment efforts in the context of a medium-term program for the period 1987-90. Given the predominantly structural nature of the problems facing the economy, the authorities are appropriately seeking use of Fund resources under the extended Fund facility and the structural adjustment facility. The program consists of a wide range of policy measures, the timely implementation of which should help to alleviate growth-impeding structural weaknesses and achieve the basic objectives of the program in the areas of growth, inflation, and balance of payments.

The baseline scenario for the balance of payments indicates that, on the basis of the policy measures envisaged in the program--including those aimed at achieving a progressive movement toward a realistic and flexible exchange rate, coupled with the liberalization of the trade system--Ghana could attain a viable external payments position by the end of 1990, while sustaining import levels consistent with the targeted growth of real GDP. As the staff illustrates under alternative scenarios, however, the balance of payments outlook is highly sensitive to changes in the domestic policies and the external environment. It is therefore important that the authorities rigorously implement the contemplated reforms. As emphasized by Mr. Salehkhou and the staff, it is equally important, especially in view of Ghana's heavy debt burden, that the adjustment effort be supported by substantial, official external assistance.

Finally, this chair supports the proposed decisions. I hope that the approval of the requested arrangement under the extended Fund facility will signal the revitalization of that facility.

Mr. Posthumus remarked that developments in Ghana--including real GDP growth, consumer prices, gross investment, and domestic savings--had been favorable since 1983, even though much remained to be done. Indeed, the period of the stand-by arrangements appeared to have contributed to the first adjustment steps and had laid the basis for growth. The request for the combination of Fund support under the extended Fund facility and the structural adjustment facility was interesting; and while he did not object to it, it was not clear to him why that combination had been proposed. Perhaps it had seemed efficient in terms of conditionality. Staff comment on that point would be helpful.

The success of monetary policy would mean that the exchange rate would be allowed to reflect fully market forces, Mr. Posthumus continued. Moves to increase the flows of foreign exchange into the auction market were therefore appropriate. He wondered whether Ghana's freely floating exchange rate under the auction system would always be fully appropriate. At present, it was probably appropriate; given the long period of overvaluation, the economy had had to adjust to a new set of market-oriented economic policies, and the exchange rate that reflected the underlying situation still had to be found. Nonetheless, he continued to hold the opinion that in the end, small, open economies would find it helpful to peg their currencies either to another currency or to a basket of currencies. After the adjustment policies had taken hold and the parallel exchange market had been eliminated, it might be preferable to move from the auction market system to an exchange rate policy based on such a peg.

He had been surprise to read in the staff paper that debt rescheduling with creditors under the auspices of the London and Paris Clubs was not being envisaged by the authorities, Mr. Posthumus indicated. Medium- and long-term debt to bilateral creditors was substantial, and debt to the Fund and other multilateral institutions was not insignificant; nevertheless, bilateral debt would still range from $800 million to $1 billion until 1991, representing one third of the total debt burden. He wondered whether, in the light of Ghana's substantial adjustment efforts, creditors could not do more. The staff appraisal had indicated that external assistance was necessary, and on very soft terms, but such assistance was not certain. It seemed that some strengthening of the financing element of the long-term program that Ghana was embarking upon, might be better than the introduction of a contingency mechanism. Staff comment on that point would be helpful.

Mr. Rousset commented that he had been quite impressed by the progress that Ghana had made over the past three or four years. Ghana's proposed program seemed exemplary with respect to the scope of reforms and the amount of assistance. Furthermore, it was the first proposed arrangement under the extended Fund facility for sub-Saharan Africa in the past few years.

The breadth of adjustment undertaken in the areas of exchange rates civil service retrenchment, and farmgate prices for agricultural products spoke for itself, Mr. Rousset said. Under the proposed program, the authorities intended to take additional decisive steps in those areas as well as in the public enterprise sector. He had been particularly interested by the measures scheduled for the improvement of the mobilization of domestic savings through the reform of the banking system, the widening of its role, and the development of a securities market. Those reforms were most welcome.

The considerable amount of external assistance from the World Bank and bilateral donors had enabled the authorities to implement such far-reaching reforms, Mr. Rousset observed. Indeed, that assistance had been instrumental in fueling growth. It had allowed for an increase of imports consistent with the reconstruction requirements and with the need to make goods more available to the population. That assistance had also enabled the authorities to adopt a realistic pace in implementing measures such as the unification of the exchange rate. In sum, the level of assistance extended to Ghana had made it possible to strike a realistic balance between adjustment and growth. The experience in Ghana indicated that adequate funding could be an essential condition for securing the firm commitment of governments to programs that were painful to implement. In that respect, the success of the current initiative to enhance the structural adjustment facility would be a decisive step in the right direction.

Finally, Ghana had demonstrated that the elaboration of a policy framework paper could place a country in the right position to benefit from an arrangement under the extended Fund facility, Mr. Rousset concluded. He shared the views of Mr. Ouanes on the mutually supportive role of the structural adjustment facility and the extended Fund facility. Indeed, the time frame and the focus were quite similar. He hoped that in the near future other such cases would be presented to the Board. He supported the proposed decisions.

The Deputy Director of the African Department said that it might be helpful at the outset to recall the background of Ghana's request for an extended arrangement and to outline the rationale for the use of that approach. When the authorities had adopted their Economic Recovery Program in 1983, their efforts were focused rightly on coming to grips with the economic and financial crisis facing Ghana. With the effective implementation of a number of adjustment measures, the immediate--or short-term--problems had been largely resolved. However, as the staff had emphasized in its appraisal, Ghana still faced major structural and financial problems. Accordingly, the authorities had shifted their attention to structural issues in the areas of production and trade, among others, with a view to achieving a viable external payments position consonant with sustainable economic growth by the end of the program period. Consistent with that basic shift in policy orientation, and given that the implementation of the reform program would require sustained efforts and external assistance over several years, the authorities had felt that the resources of the extended Fund facility and the structural adjustment facility would be the most appropriate in the circumstances. The staff also believed that the requests were justified, in view of the structural nature of Ghana's problems and the strength of its medium-term program. The objectives and policies to be pursued during the period 1987-90 were adequate for the solution of the country's structural and financial problems, and the policies and measures for the first year, which included a number of important prior actions, were substantial. In addition, the extended Fund facility had certain attractive features for Ghana, especially a longer repayment period, and it fitted sensibly within the time horizon required by the structural adjustment facility.

It was somewhat difficult to specify, as one Director had requested, what made Ghana so special that a request for an extended arrangement was warranted for that country and not for others, the Deputy Director indicated. A comparison with other countries seemed to be outside the scope of the current discussion. However, Ghana's medium-term adjustment program did contain many of the desirable elements that the Executive Board had cited in its discussions on the use of Fund resources, particularly extended arrangements, and what kind of program was best suited for such arrangements. For example, Ghana's program included a clear statement of objectives and policies for the entire thee-year period, a detailed specification of policies and measures for the first year, and a strong degree of adjustment with significant steps toward that process at an early stage. Ghana's specification of policies and measures for the first year, but not for the entire program period, was fully consistent with the decision on the extended Fund facility.

Among the commendable features of Ghana's program were the substantial progress already made by the authorities in reducing price distortions, as well as the investment program and structural support measures that had been elaborated with the World Bank, the Deputy Director added. On that basis, the staff believed that there was a reasonable prospect that Ghana could achieve a viable external payments position together with sustainable economic growth by the end of the extended arrangement, which was another desirable element in programs supported by the extended Fund facility. As some Directors had noted, Ghana's medium-term adjustment program did involve some risks and uncertainties but overall, the staff considered it a plausible program.

While it was true that periodic slippages had occurred owing to weaknesses in public sector management, it was noteworthy that, despite those slippages, the authorities had made major adjustment efforts with considerable success since 1983, the Deputy Director recalled. Moreover, and perhaps more important, the authorities were keenly aware of those difficulties and had undertaken a far-reaching program to strengthen the analytical and managerial capacities of the key ministries through a special institutional support project approved by the World Bank. The World Bank had also recently approved a public enterprise project to support the Government's program of divestiture and rationalization of state-owned enterprises. Furthermore, the special monitoring and policy analysis committee, headed by the Chairman of the Bank of Ghana, was expected to provide additional managerial support. Finally, both the Bank and the Fund would continue to extend technical assistance to the authorities. The Fund had been providing, and would continue to provide, assistance in tax reform, budgeting, monetary statistics, and reform of the exchange and trade system. The Fund's resident representative in Accra would also continue to assist the authorities not only in the implementation of the program, but also in dealing with changes in the country's circumstances as they arose.

In setting up their medium-term program, the authorities had struck an appropriate balance in the three key areas of growth, inflation, and balance of payments adjustment, the Deputy Director continued. Like many Directors, the staff was concerned about the high rate of inflation in Ghana, and considered it particularly important to bring down the rate of inflation to 8 percent by the end of the program period. In the event that progress was not as rapid as foreseen, the staff would need to discuss with the authorities additional measures to effect the targeted reduction. The staff believed that, while the supply-side measures were being implemented, it would be essential for the authorities to pursue an appropriately tight monetary policy. The achievement of the targeted reduction in the rate of inflation was based on an effective implementation of both the supply-side and demand-management measures specified in the program.

In considering whether the average annual growth target of 5 percent was attainable, it was to be noted that the economy was expanding from a relatively low base, and that the targets were consistent with Ghana's recent growth experience, the Deputy Director indicated. Ghana's rate of growth had been 8.7 percent in 1984, 5.1 percent in 1985, and 5.3 percent in 1986. There was still a great deal of unused capacity, and the economy was expected to move toward levels that were historically realistic--it was not as if Ghana was moving to a much higher plateau than had ever been achieved before. In addition, a large investment program was scheduled to be implemented, and its size and financing were considered appropriate and realistic by the World Bank. To finance the programmed increase in investment, a correspondingly large rise in savings was required. The increase in savings was expected to emanate from (1) further improvements in fiscal performance; (2) reform of the state enterprise sector; (3) the financial sector reforms; and (4) the pursuit of a flexible interest rate policy.

The medium-term objective of reducing civil service employment by about 5 percent a year had been included in the program because considerable overstaffing existed, the Deputy Director remarked. The number of civil servants in Ghana, as a percentage of the population, was quite high compared with other countries. In addition, if 5 percent of the civil servants could be redeployed annually to other activities, the Government would have more scope for providing better remuneration to those civil servants who remained.

Price controls continued in effect for public utilities, and for items such as petroleum products, cement, fertilizers, beer, and cigarettes, the Deputy Director mentioned. It was hoped that, with the exception of public utilities, the remaining controls could be lifted over the program period. In Ghana, price controls did not necessarily entail subsidies; the Government's policy had been flexible in that regard--for example, periodic adjustments had been made in the prices of petroleum products in the light of changes in world market prices and exchange rate movements.

The authorities had launched a two-year plan of corrective action for public enterprises, the Deputy Director noted. Of the 180 public enterprises in Ghana, 30 that weighed heavily on the budgetary resources of the Central Government had already been identified for outright sale, conversion to joint ventures, or liquidation. The staff did not have sufficient details to assess the weight of those enterprises relative to GDP. If those programmed for outright sale were not actually sold, they would continue to be a burden on the budget, and hence the authorities would need to consider alternative solutions, such as their liquidation. With regard to the enterprises remaining in the Government's portfolio, the operations of 14 major enterprises would be rationalized; three-year corporate plans were to be prepared by those enterprises, and performance agreements would be concluded with the Government according to an agreed schedule, with some agreements targeted for conclusion by December 1987.

To encourage cocoa production and exports, the authorities had made major adjustments in the price paid to cocoa farmers, and they intended to increase the price further to an indicative target of 55 percent of the world market price for the 1989/90 crop year, the Deputy Director observed. It was not easy to assess whether that percentage should be higher. The authorities' establishment of such a target, after discussions with the World Bank, took into account (1) the need to reduce the costs of the Cocoa Board, and a number of steps had already been taken to that end; (2) the importance of retaining some resources in the form of tax revenue; and (3) the advisability of providing some margin for contingencies.

As the auction for treasury bills had started only on October 30, it was too early for the staff to report on Ghana's experience with that system, the Deputy Director mentioned.

Responding to questions about the underlying assumptions in the program regarding inflation and overall financing--and the actions planned if those assumptions did not materialize--the Deputy Director said that although the staff paper did not to attempt articulate fully all the possible eventualities, the staff did believe that Ghana's growth prospects were promising and the targeted reduction in inflation feasible. The external financial support envisaged in the program was based on the indications given by creditors and donors at the meeting of the Consultative Group for Ghana in May 1987, as well as on assessments made by the Fund and Bank staffs. Moreover, reviews had been scheduled at regular intervals in the program precisely to deal with changing circumstances and with assumptions that did not in fact materialize. A technical mission of the Fund was scheduled to visit Accra beginning November 23, and the issues mentioned by Directors would be considered then on a preliminary basis, to be followed by the first review of the program in January 1988.

As one Director had noted, all the financial incentives might be in place, but structural problems might continue to hinder growth, the Deputy Director continued. It was for that reason that the public investment program, developed in collaboration with the World Bank, placed great emphasis on investment in infrastructure and on the removal of bottlenecks in transportation, telecommunications, and the like--in fact, those expenditures accounted for about 42 percent of total public investment. Moreover, the World Bank had developed a technique in programs for many countries whereby the public investment program was kept under continuous review to take account of new developments and changes in circumstances; the establishment of the rolling public investment program for the next three-year period (1988-90) was a structural benchmark under the structural adjustment arrangement, precisely because it was considered particularly important.

Finally, no rescheduling had been included in the program because most of Ghana's debt was to multilateral institutions, including the Fund, the Deputy Director from the African Department concluded. There was not much that could be rescheduled on the basis of bilateral loans. Moreover, there was an expectation that official creditors would be putting substantially more resources in Ghana throughout the program period, and there was a strong hope that the commercial banks would be doing likewise, particularly since the program envisaged a substantial settlement of Ghana's arrears to banks. In addition, barring major changes in rescheduling arrangements, debt reschedulings had been expensive in the recent past.

Mr. Sengupta commented that the issue that he had been raising on Ghana's program in fact had implications for many other programs, and thus some of those issues needed to be pursued at somewhat greater length. He had asked a series of "what if..." questions not so much to elicit a specific response as to highlight the need for contingency mechanism procedures.

He had also asked some more basic questions, specifically, on how the staff had arrived at particular estimates, including the rate of inflation or growth, Mr. Sengupta recalled. Such issues were important, because there had to be some mechanism by which the staff had estimated that the inflation rate--which had been about 50 percent for the past four years--would drop to 15 percent, 10 percent, and 8 percent in the three years of the program. While it was of course possible to reduce the inflation rate to those levels, Ghana was facing a period in which the exchange rate would decrease sharply, cocoa prices would be fluctuating considerably, and price and interest rate liberalization, among other things, would be occurring. Thus, how the staff had arrived at that projected deceleration in the inflation rate was a question that had to be answered before a contingency mechanism was elaborated.

Given that the rate of inflation was a projection, one had to be able to determine the effect of certain policy instruments on the level of output, Mr. Sengupta added. For example, it was important to be able to estimate how much one needed to tighten domestic credit to help bring down the rate of inflation. Similarly, the projected growth rate in the program was based on assumptions related to investment levels, interest rates, and domestic savings rates, Mr. Sengupta went on. He wondered whether the projected rate of investment was realistic or feasible, particularly because it was considerably higher than that of the base year, 1986. Furthermore, 1986 appeared to be more an atypical than a representative year, which gave rise to the question about why it had been chosen as the base year. The projections for the rate of domestic savings represented an even higher jump from the base-year rate, and he wondered how such an increase could be expected. If domestic savings did not rise according to plan, then of course additional financing would be required.

In sum, the staff needed to go into considerable detail in the exercises related to the underlying assumptions for medium-term programs that were to be supported by extended arrangements, Mr. Sengupta concluded. It was also necessary to pinpoint possible trouble spots and to outline in advance the appropriate responses if problems should develop. He thought that the contingency mechanism approach could include many aspects--for example, policy responses by the country, multilateral institutions, and the international financial community, as well as options such as debt rescheduling.

The Deputy Director of the African Department observed that two aspects supported the feasibility of the targeted rate of inflation in Ghana's program; on the supply side, it was expected that a certain real expansion in production would occur, and on the demand-management side, a monetary program had been devised that was consistent with the envisaged rate of inflation. The inflation rate goal was ambitious, but it was to be noted that as recently as 1985 a good supply response and a sufficiently tight credit policy had enabled the authorities to keep Ghana's inflation rate at about 10 percent.

An important point related to domestic credit was that the prospective improvement in fiscal performance would permit net repayments of government debt to the domestic banking system of ₵ 5.5-6.5 billion a year over the program period, which would allow enough scope for credit to the private sector to grow broadly in line with nominal GDP, the Deputy Director added. It was true that credit to the private sector would be constrained in the second half of the current year. The original credit objectives of the stand-by arrangement had been left practically unchanged because at a time when the rate of inflation was moving beyond the original target, it was not wise to change the credit program.

Given the state of some of the national accounts of Ghana, it was not possible to say definitively whether or not 1986 was a representative year, the Deputy Director of the African Department mentioned. Nonetheless, it was the base year that the Fund and Bank staffs had been using. As already noted, the Bank staff believed that it would indeed be feasible for the authorities to raise the investment level as indicated in the program and was also reasonably confident about the projected means of domestic and external financing. Any significant deviations from the projections would be examined in the context of the scheduled reviews of the program, and, clearly, would require a combination of additional adjustment and financing to keep the program on track.

The staff representative from the Exchange and Trade Relations Department commented that the proposed access did suffice to make Ghana's program fully financed, but of course that did not mean that Ghana was not able to put additional external assistance to good use, particularly because the country's usable reserves were quite low. The additional resources emanating from the adjustment efforts were being used to a large extent to reduce liabilities, and thus Ghana's assets position was not comfortable. However, since at present it was not prudent to borrow at commercial rates in order to bolster reserves, any new concessional resources coming into Ghana could be put to good use to rebuild those reserves.

It was expected that under Ghana's program, normalization of relations with the financial markets would be attained, and in such a way--partly through trade liberalization and other current account transactions--that it would be sustainable, the staff representative continued. As shown in Table 7 of Supplement 1 to EBS/87/207, the bilateral creditors were expected to increase their exposure slightly over the program period.

Similarly, in the balance of payments table (Table 6), it was expected that the private net capital inflows would more than offset the arrears, and it was thus envisaged that both official creditors and the banks would increase their exposure in Ghana over the program period. However, an attempt to attain a similar increase in exposure through debt relief would lead to a reaction from the export credit agencies that were currently open to Ghana, and similarly from the banks that were providing short-term trade financing to the country; consequently, at the end of the program period, Ghana would have difficulty in meeting its financing objectives.

An advantage of the use of the extended Fund facility in tandem with use of the structural adjustment facility was that such a combination permitted a symbiosis between the adjustment supported by the structural adjustment facility and the medium-term commitments supported by the ordinary resources of the Fund, the staff representative added. Ghana had been able to formulate its medium-term policies with an up-front commitment from both sides, which would not have been possible with three successive stand-by arrangements. Accordingly, such a combination of support was most helpful to the policymakers in Ghana, because they were assured that the Fund would be there for the three years in which they were effecting their reforms. Contrary to the suggestion that the extended Fund facility program had been piggy-backed on the program supported under the structural adjustment facility, the medium-term objectives and targets under each arrangement were separate and distinct, but they did complement each other in the overall medium-term policy package.

Directors who wanted Fund-supported programs to be coterminous with the budget year of the member country were imposing a straitjacket on the programs, the staff representive stated. In the context of an extended arrangement in particular, the regularly scheduled reviews permitted sufficient input at the time of the budget formulation, and thus parallelism between the program and budget years was not required.

The authorities were allowing the exchange rate to be determined in the context of a weekly auction, thus permitting it to move according to demand rather than supply management, the staff representative indicated. Accordingly, it was not clear how much closer the auction and parallel market rates should be. To the extent that there were restrictions on capital movements and that other considerations existed, there would always be transactions outside the auction or the banking markets until there was sufficient depth in the market to remove those restrictions. Thus, if a small share of nontrade-related transactions moved through that market, then the parallel market did not offer much indication whether the exchange rate was appropriate in the auction market. A differential of 30 percent between the rates was not necessarily the right one. When the differential between the two rates was at three-digit levels, it was clear that the rate in the auction market needed to move; with a 30 percent differential that clarity was diminishing. An examination of the differential between the rates was appropriate in the context of the normal review process. With respect to pegging the exchange rate to another currency or to a basket of currencies, the the authorities might well wish to consider such an option. However, as long as those were large imbalances that, manifested themselves in terms of the rate of inflation and in a restrictive system, the time to peg and force action into budgetary responses had presumably not come.

The data showed that during periods when both extended and stand-by arrangements had been in effect, 12 percent of the extended arrangements had been completed, compared with a completion rate of 40 percent for stand-by arrangements, the staff representative from the Exchange and and Trade Relations Department reported. However, the completion rate for the first year of extended arrangements had been 60 percent, and that for the second year, 25 percent. The data were difficult to interpret; Mr. Fogelholm had offered a plausible explanation, namely, that the extended arrangements had covered periods in which there had been very large deviations from program assumptions owing to the strength of external disturbances. She did not consider the extended Fund facility an inflexible instrument. If the deviations from the program became so great that the objectives could no longer be met, it was always possible to abrogate the extended arrangement and replace it with one having more appropriate objectives and more appropriate means of meeting those objectives. Accordingly, the extended Fund facility was a useful instrument. Finally, if Ghana was not an ideal candidate for such an arrangement, she wondered who would be.

Mr. Sengupta asked whether, for a financially unstable country with distortions in its balance of payments, an exchange rate policy that included a market auction would give a better index of the stability of the exchange rate than pegging would. The question needed more examination, because it seemed that if the system was unstable, the possibilities of market failure were much greater. As Mr. Posthumus had suggested, pegging might indeed be a better solution.

The staff representative from the Exchange and Trade Relations Department observed that for a country with widely diverging official and parallel market rates, it was useful to institute an auction system. In Ghana, the auction system had helped narrow the spread between the rates and had achieved a much better balance between the demand and supply of foreign exchange. With the pegging system, political difficulties sometimes arose with respect to the degree and direction of exchange rate management. While it was true that for a country with imbalances, the auction system did not provide totally unambiguous signals, at present it seemed to be the preferable system.

Mr. Salehkhou remarked that the timing of Ghana's requests had been based partly on the assumption that the Interim Committee already would have reviewed the reports from the Group of Ten and the Group of Twenty-Four, and that any proposed changes and improvements in the extended Fund facility would have taken effect. However, that had not happened. Accordingly, and in the light of the Fund's policies--of assisting members who came to the Fund at an early stage of their difficulties, and of maintaining uniformity of treatment for all members--he wished to request that whatever improvements were eventually incorporated in the extended Fund facility would also apply retrospectively to Ghana's extended arrangement. Moreover, as some Executive Directors had indicated, the targets in Ghana's program were ambitious and might be difficult at times for the authorities to meet. Ghana's record of success with its three recent stand-by arrangements had made it an acknowledged symbolic case, and the authorities hoped to act again as pioneers with an arrangement under the extended Fund facility. Nonetheless, any improvements that could enhance the overall success of that facility should be applied to Ghana's extended arrangement as well.

The Acting Chairman responded that, while it would be most difficult to make a commitment in advance of a policy discussion on the extended Fund facility, it was clear that management and staff would take Ghana's situation into account in assessing whether any changes ought to apply retrospectively to Ghana's extended arrangement. That decision would ultimately be taken by the Board, of course, and he was sure that Directors would approach the issue with open minds.

The Executive Board then adopted the following decisions:

Extended Arrangement

1. The Government of Ghana has requested an extended arrangement in an amount equivalent to SDR 245.4 million for a period of 36 months from November 6, 1987 to November 5, 1990.

2. The Fund approves the extended arrangement set forth in EBS/87/207, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b) (iii)

Decision No. 8723-(87/154), adopted
November 6, 1987

Structural Adjustment Arrangement

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

2. The Fund notes the policy framework paper for Ghana (EBD/87/247).

3. The Fund approves the arrangements set forth in EBS/87/207, Supplement 3.

Decision No. 8724-(87/154), adopted
November 6, 1987

2. MAURITANIA - 1987 ARTICLE IV CONSULTATION, REVIEW UNDER STAND-BY ARRANGEMENT, AND STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1987 Article IV consultation, the review under the 12-month stand-by arrangement with Mauritania approved on May 4, 1987, and Mauritania's request for an arrangement under the structural adjustment facility (EBS/87/218, 10/15/87; and Sup. 2, 11/16/87). They also had before them a statistical annex on Mauritania (SM/87/252, 11/2/87; and Cor. 1, 11/3/87) and a policy framework paper (EBD/87/262, 10/15/87).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their October 27, 1987 discussion in Committee of the Whole of a paper entitled "Mauritania - Policy Framework Paper, 1987-90."

1. The Executive Directors, meeting as a Committee of the Whole, reviewed the Policy Framework Paper for Mauritania in the 1987-90 period. The objectives and action programs contained in the paper were well received. The Executive Directors noted the vulnerability of the economy to external factors, especially in the rural sectors and mining. Even so, the Government's impressive efforts have resulted in substantial progress in correcting the major imbalances in the economy. In particular, the Executive Directors welcomed progress in encouraging productive activities, in reform of the public enterprise and banking sectors, in strengthening public investment selection and public finances, and in improving the incentive structure for the private sector.

2. Three separate sets of issues were raised: (a) reinforcing growth prospects in different sectors; (b) coping with the social aspects of adjustment; and (c) meeting financing needs.

3. There were questions about growth prospects, given the country's meager resource base and the constraints imposed by such intractable problems as desertification and rapid population growth. There were also questions about the pace of price liberalization in the agricultural sector. The staff noted that the irrigation sector donors' meeting will present an opportunity for addressing a number of long-term issues jointly with the Government and formulating appropriate plans of action.

4. In the fisheries sector, the Executive Directors noted the administrative difficulties of tighter surveillance to prevent overfishing and the need for improved investment incentives to

national operators. The staff emphasized the role of the sectoral donors' meeting as a means of strengthening implementation of this approach.

5. Promotion of private sector activity was supported by the Executive Directors, who noted the importance of timely implementation of reforms in trade and investment incentives, and in the banking sector. It was noted that the reform of exchange rate and pricing policies had helped promote trade so far, but that continued emphasis on import substitution and export promotion is highly desirable. However, one Executive Director cautioned against an excessive pace of liberalization. Regarding banking sector reforms, there was support for the Government's approach and acknowledgment of the complexity of the issues involved.

6. The social aspects of adjustment policies were commented on by several Executive Directors. There were references to the negative impact of ongoing reforms on employment, and support was expressed for the measures being proposed and taken to expand employment opportunities over the long term. Use of food aid to mitigate social costs was welcomed, and support was also expressed for the Insertion and Reinsertion Fund concept.

7. The discussion addressed the financing needs of the country. The proposed program envisages a gradual reduction in the level of exceptional financing required over the next three years, but concern was expressed that debt service may be absorbing too much resources, that debt reschedulings should be more comprehensive, and that past debt reschedulings may lead to an increased external financing gap in the early 1990s. Deferral of the debt problem is not a satisfactory outcome, and Executive Directors noted that future debt reschedulings should be on highly concessional terms. Directors expressed support for recent initiatives to provide debt relief to African countries.

8. Finally, there was agreement among the Executive Directors that IDA should continue to play a leading role in support of the country's development programs, especially in the human resource sectors.

9. As a postscript, note was taken that some Executive Directors raised questions of a more methodological nature about the PFP process, and the papers' level of generality.

Mr. Mawakani made the following statement:

Since early 1985, Mauritania has launched a comprehensive medium-term adjustment program aimed at correcting the severe domestic and external financial imbalances and removing the obstacles to economic growth that had developed over the years.

This adjustment program has received the support of donors, creditors, and international institutions, including the Fund. The Fund' s support has been in the form of successive stand-by arrangements, and a three-year arrangement under the structural adjustment facility.

During the Board discussions last May on Mauritania's request for a stand-by arrangement, Executive Directors had the opportunity to review economic and financial developments in the country in 1986. Therefore, I will not dwell on these developments except to say that the encouraging trends that were shown in the preliminary data have been confirmed. Real GDP is now estimated to have increased by more than 5 percent, compared with about 3 percent that had been previously estimated. Inflation as measured by the GDP deflator has been halved to about 8 percent, and the consolidated government deficit, on a commitment basis and including grants, has been reduced from 4.5 percent of GDP in 1985 to less than 0.7 percent in 1986. In addition, the external sector position showed significant improvement in 1986 with the current account deficit, including grants, being reduced to about 10 percent of GDP, from about 13 percent in 1985.

During the first eight months of 1987, the Mauritanian authorities have continued to vigorously implement the measures envisaged in the programs. On the whole, developments are in line with the programs' objectives. However, in such a wide restructuring program which encompasses all sectors of the economy, unexpected problems are bound to occur. The authorities encountered some difficulties in the earlier part of the year, with respect to the reform of the banking sector. The two state banks that had been targeted for privatization ran into liquidity problems because of excess withdrawals of deposits. Furthermore, there was a need to finance large stocks of fish products which could not be exported in time. These factors, among others, caused some monetary targets to be exceeded. However, by August, the situation was back to normal and the program is on track. Difficulties of a technical nature were encountered in respect to the new iron ore mining company, and its contribution to real GDP growth in 1987 will be less than originally projected.

Success was, however, achieved in the agricultural sector, where output is responding positively to the incentive measures that have been adopted. Similarly, fishing output is expected to show significant gains. The rehabilitation of the public enterprise sector is also proceeding according to plans, and the enterprises that have been selected for rehabilitation are showing financial improvements. The performance of the external sector is in line with program targets, and the current account deficit is expected to be reduced further in 1987.

The objectives for the restructuring of the Mauritanian economy for the year ended July 1987 have been met. As to the implementation of the stand-by arrangement, all the performance criteria for the period ending September are also expected to have been met. Encouraged by the progress achieved thus far, the Mauritanian authorities are determined to continue their adjustment efforts in a medium-term framework, and have accordingly updated and extended the original policy framework paper for which they are requesting the second annual arrangement under the structural adjustment facility.

For the period mid-1987 to mid-1990, the major macroeconomic objectives remain unchanged, namely, the achievement of satisfactory economic growth, the reduction in inflation, and the gradual elimination of the external imbalance. To attain these objectives, the Government will continue to implement with determination its economic and financial strategy based on prudent demand-management and structural reforms. The promotion of private sector activities and improvement of the efficiency in the public sector will constitute important elements of that strategy. The details of these measures are well described in the policy framework paper and the staff report, and I would like to highlight some of the objectives and measures that the Mauritanian authorities intend to take over the next fiscal year to achieve these objectives.

In the private sector, the objectives are to increase food production and encourage the development of small-scale industries. The authorities are pursuing the first objective by providing the appropriate regulatory framework and incentives to encourage the private sector to increase its participation in the production, processing, and marketing of cereals and other food crops. With regard to small-scale industries, which could contribute significantly to economic growth, the authorities are preparing an investment code with the appropriate fiscal incentives to encourage investment in that sector. This will be supplemented by the creation of a corporation whose mandate will be to provide the necessary assistance to investors. In the same context, the external trade system will be liberalized and a flexible exchange rate policy will be maintained.

In the public sector, emphasis will be placed on tax reform in order to increase the tax base and to make the tax system more equitable. With regard to expenditure, priority will be given to improving the budgetary process of both ordinary and investment expenditures, and to strengthening the process of investment planning and selection. Public investment will be reduced to about 20 percent of GDP, and emphasis will be placed on the rehabilitation of the existing infrastructure. With regard to public enterprises, the authorities will reduce the monopoly powers of some of the parastatals and allow the private sector to compete in the production of similar goods.

The complete restructuring of the banking sector is under way. Two state-controlled banks are in the process of being privatized with foreign and domestic participation, and the authorities intend to introduce a new banking law that will allow for stronger central bank supervision. A new accounting plan will be introduced, and the structure of interest rates will be simplified.

As described in the staff papers and the policy framework paper, substantial changes have already been introduced in the Mauritanian economy in a rather short time. There is no doubt that these changes are needed to put the economy on the path of sustainable growth and financial equilibrium. Although these economic reforms have caused social hardships, the authorities are committed to the adjustment process and intend to pursue their present efforts. As noted by the staff, the country will continue to rely on external support and understanding for the immediate future to pursue the adjustment process and to alleviate the adjustment burden on certain sectors of the population.

Mr. Rousset said that he was pleased with the progress achieved under both the stand-by arrrangement and the first annual arrangement under the structural adjustment arrangement.

While a further reduction of the fiscal and external deficits had been attained, many structural reform measures had been implemented, such as: rehabilitation of key public enterprises, reduction of customs duty exemptions, reform of incentive policies in the agricultural and industrial sectors, and restructuring of the banking system, Mr. Rousset commented. In spite of a few delays, this program, which may have appeared overambitious when it had first been approved in September 1986, was indeed well under way, owing to the strength of the authorities' commitment.

However, much remained to be done to further liberalize the economy and to make it more conducive to increased activity from the private sector; that particular objective was at the center of the authorities' strategy, Mr. Rousset remarked. Regarding the pace of reforms to be implemented in the import and pricing systems and the degree of protection of local industries, he endorsed the authorities' willingness to adopt a steady, prudent approach which took the present weakness of the production base and the vulnerability of the economy to external factors into consideration.

He would not elaborate on Mauritania's objectives and strategies, because there was no substantial difference between the updated policy framework paper and the one approved in September 1986, and the same could be said of the review of the stand-by arrangement, Mr. Rousset continued. However, he had noted that the current account deficit target had been revised for several reasons, one of which was to allow for a somewhat higher growth rate of imports which was said to have been needed to support economic growth. Given the link usually made between the level of imports and the growth rate of GDP, he wondered whether the GDP growth rate forecasted had been revised accordingly.

The exemplary relations prevailing between Mauritania and the Fund and the obvious need for further Fund assistance made the conclusion of a new stand-by arrangement at the expiration of the present one in May 1988 essential, Mr. Rousset observed. Such an arrangement would be in keeping with the supplementary nature of the structural adjustment facility. His authorities supported the proposed decisions.

Mr. Enoch said that he continued to be impressed with the authorities' adjustment efforts: significant progress had been made in reducing imbalances within the economy; the process of structural reform was under way; price and trade liberalization measures were being put in place; steps were being taken to strengthen the performance of the public enterprises; and the depreciation of the exchange rate had contributed to strengthening the external performance. Output growth had responded favorably to those efforts, and the projected growth rate for 1987 would apparently have been attained had it not been for technical difficulties in the iron ore sector.

The authorities were planning to continue to devote a large amount of resources to the public investment program, and he was pleased that they had consulted closely with the World Bank in that regard, Mr. Enoch remarked. The growth performance of recent years suggested that the past incremental capital-output ratio had been on the high side; the staff should comment on the outlook for that ratio over the medium term.

The papers before the Board would have benefited from more attention to producer prices in other relevant countries, Mr. Enoch added. For example, on some occasions cattle had been smuggled across the border and sold in neighboring countries. That development may have merely been a reflection of prices taking time to adjust in response to exchange rate changes. However, papers on countries such as Mauritania should take producer prices into account. In addition, the staff papers lacked specificity in their description of several important areas of structural reform. That was not to say that important progress was not being made, but rather that more detail on the proposed policy reforms would have been helpful. His chair had made that observation about several recent reports on arrangements under the structural adjustment facility and would return to that issue during forthcoming discussions on monitoring structural policies in the context of Fund programs. He supported the proposed decision.

Mr. Al-Assaf stated that on the occasion of the previous Article IV consultation with Mauritania, his chair had been impressed with the improvement in Mauritania's economic prospects. Good progress had again been made over the past year. He commended the authorities for their determination in adhering to the objectives of restructuring the economy, broadening the productive base, and improving the use and allocation of resources. The support and assistance requested from the Fund and the World Bank in the context of the authorities' present and future efforts would contribute to a further improvement in Mauritania's economic prospects, and therefore, he supported the proposed decisions.

In view of the broadly satisfactory implementation of the adjustment program, the best recommendation that could probably be made to the authorities was to stay on course, Mr. Al-Assaf concluded. The efforts to reform the tax system should continue. One objective of the reform had been to assist in achieving a better balance between revenues and expenditures. That objective had been achieved, and even overachieved, with the emergence of treasury surpluses. However, the need to improve efficiency in the allocation of resources called for the continued implementation of the planned reform of the fiscal system.

In line with the essential objective of improving the allocation of resources, the liberalization of the economic system must be pursued further, Mr. Al-Assaf remarked. The authorities' task in that area was a difficult one. Further liberalization and private sector involvement would benefit a broad range of economic activities and would clearly require time and dedication.

Despite the previous achievements, the authorities' adjustment efforts would continue to be carried out in the context of a very fragile overall economic situation, Mr. Al-Assaf noted. Exceptional assistance, on highly concessional terms and in appropriate amounts, would continue to be needed for some time. In view of their successful efforts, however, the authorities were fully deserving of that assistance.

Mr. Othman made the following statement:

> It is encouraging to note that the comprehensive medium-term adjustment program, which involves wide-ranging structural reforms and extensive demand-management policies, has achieved significant progress in 1985 and 1986 and is proceeding generally well in 1987.
>
> It is also encouraging to note how national commitment together with international support can produce such commendable achievements. I appreciate this cooperation and look forward to its enhancement in order to enable the Mauritanian authorities not only to maintain the gains that have already been realized, but also to improve future growth with fiscal and balance of payments viability. The program that has been drawn up for July 1987-June 1988 should serve to carry forward in a significant way this adjustment process.
>
> Since this chair is in broad agreement with the staff analysis, I will mention only a few specific points. Although the experience of previous years is a source of optimism, Mauritania's

meager resource base and the constraints imposed by such intractable problems as desertification, rapid population growth, and the high vulnerability of the economy to external factors, require a great deal of diligence on the part of the country and an adequate level of external support. However, it is encouraging that the authorities are firmly committed to pursuing their objectives and that the external support is forthcoming. This increases confidence both inside and outside the country and gives a new impetus to the economy. My authorities welcome the news that the financing gap of the balance of payments for the period covered by the second program under the structural adjustment facility is ensured.

The education system is undergoing a major restructuring to achieve a wider participation by the private sector, curtailment of expenditure for scholarships and foreign teachers, and larger reallocation of resources to primary school education. I understand the authorities' concern about reforms in this sector, but wish to stress the importance of improving human capital at all levels. In this regard, private participation can play a useful role, but caution is perhaps needed to ensure that access to education continues to all segments of the population.

In Appendix I on page 34 of EBS/87/218, it is noted that the authorities estimated the rate of inflation during the first seven months of 1987 to be 9.8 percent higher than in the same period of 1986, while the staff have cited on page 7 of the same paper a 7.5 percent rate for the 12-month period ending in August 1987, and 8.8 percent for the whole year. On both counts, the rate is high and requires careful monitoring, if the objective of reducing the rate from 7.6 percent in 1986 to 5 percent in 1989-90 is to be met. I am, however, pleased that the authorities have already taken the necessary financial measures to correct the situation, including the significant strengthening of public finances over the last two years and the tightening of financial policies in the third quarter of 1987.

As regards the medium-term growth target of 4 percent a year, the current annual population growth of 2.7 percent allows only a marginal increase in per capita income. Therefore, I wonder whether even this modest target could be attained in light of the growth performance during the first half of 1987; GDP growth is expected to decline from the 4.5 percent initially projected to 2.3 percent, and the ratio of investment to GDP is about the same level as that projected for the remaining period.

I commend the authorities for what they have accomplished and for what they intend to accomplish. I endorse the proposed decisions.

Mr. El Kogali said that he was pleased that Mauritania was making progress, and that the authorities deserved to be commended for their sustained implementation of a comprehensive adjustment program under difficult circumstances. The authorities had demonstrated a strong commitment to pursuing adjustment policies. While sustained implementation of adjustment was essential to restoring financial stability and economic growth, the negative social implications of the ongoing reforms were difficult to overlook, particularly because the level of income was already extremely low and the country's resource base was limited. Substantial external inflows of capital would be necessary to maintain adjustment and achieve the growth target. The Fund's continued financial involvement under the stand-by arrangement and the structural adjustment facility was welcome. However, the kind of assistance Mauritania needed most was concessional aid and long-term development assistance. He supported the proposed decisions.

Mrs. Walker made the following statement:

My authorities welcome this opportunity to review the first year of Mauritania's structural adjustment arrangement and the stand-by arrangement. The progress made is particularly noteworthy in light of the difficult structural and financial problems Mauritania faces. The emphasis on structural elements in the reform process is critical to success, and I urge the authorities to continue these reforms, particularly in the public enterprise and banking sectors. With such high remaining external imbalances, Mauritiania must proceed with this adjustment process with the same vigor throughout the remainder of the decade. In this regard, my authorities welcome the updating of the three-year policy framework, which provides a continuous guideline for policies to be taken during the next several years.

Significant progress has been made in the fiscal area, and I welcome the continued commitment to fiscal reform, including emphasis on improving public finance management. Monitoring of the investment budget, which has been a source of problems in the past, must be done carefully; thus, I welcome the strengthening of project selection and the establishment of three-year rolling plans with World Bank assistance. Furthermore, financing of public investment should be only on concessional terms. I welcome the fact that there is no planned recourse by the Government to bank credit, which will enable more credit to be channeled to the private sector.

Rehabilitation of the public enterprises has progressed, and the authorities' future plans should allow for further improvement. The substantial reform of the tax system, to be implemented soon, should also contribute to improvement in the fiscal position and to incentives for greater productivity. Reductions in tariffs as part of the investment code changes should provide incentives for investment in these enterprises. I trust that the difficulties encountered in financial management during 1987, associated with the bank restructuring, will be taken care of as the bank reforms are finalized. In this regard, I urge the authorities to complete these reforms, which should enable more support to be provided to the productive sector.

Reforms in the agricultural, energy, and fishery sectors will be critical to promoting private sector activity and increased efficiency in the economy. The new structure of agricultural producer and retail prices that will be introduced soon should be more reflective of market prices and ensure that costs are covered. Price decontrol remains a central part of the reform effort, and my authorities look forward to continued progress in implementing the recommendations made in the World Bank study completed last May. A timetable for decontrol of eight products still has not been established, and I wonder when the staff expects enterprises' cost accounting to become more reliable. The improved regulatory framework, which was brought about by the revision of the investment code, the elimination of import restrictions, and the reform of the tariff in the import licensing system, should contribute to an improved environment for private sector activity.

The policy of a flexible exchange rate should be continued to stimulate the export and import competing sectors. The overall balance of payments position remains difficult over the medium term, with the large debt service burden high. It will be essential that the authorities build on the reforms already started, particularly in the area of structural reform, where a good beginning has been made, to capitalize on the progress made thus far and provide assurance of improvement in the medium term. My authorities believe that the program for the second year under the structural adjustment facility builds on the reforms started in the first year, and they support this program. I welcome the authorities' commitment to this adjustment effort and their willingness to tackle some very difficult structural weaknessess in the economy, and I look forward to continued progress in this effort.

Mr. Goos said that he fully endorsed the staff appraisal and the staff's positive assessment of Mauritania's recent performance under the adjustment program, especially the authorities' prompt response to the financial management difficulties that had arisen early in 1987. That experience had clearly underlined the importance of rehabilitating and restructuring the banking system and strengthening bank supervision. In that connection, he welcomed the authorities' assurances that necessary reform efforts were under way.

In regard to other policy areas, there had been projections of further improvement in the fiscal position, Mr. Goos noted. Those projections indicated a need to check, and possibly reverse, the decline in the public sector revenue to GDP ratio that was expected after 1988. The authorities' efforts to strengthen public finances would not be facilitated by an erosion of the revenue base; therefore, it should be strengthened in a timely manner, especially in light of the expected financing gap in both the budgetary and external accounts. The vulnerability of the fiscal position and the limited resource base called for perseverance in the adjustment effort to safeguard the success of the program. However, the authorities continued to be committed to the adjustment effort, and he was confident that the policies envisaged for 1987-88 would help to make further improvements in the country's domestic and external balances, and, therefore, Mauritania's adjustment program deserved the Fund's continuing support.

The staff representative from the African Department recalled that a question had been raised concerning the revision of the current account target for the next two or three years, and the extent to which that revision had been brought about by the higher growth rate of imports. The current account had been revised primarily to be more prudent in light of the projection for exports, especially the volume of fish exports, which had been expected in 1986 to increase by 5 percent a year. The staff had recently reduced its projection of fish export growth, owing to some concerns the World Bank had had about the control of foreign fleets operating in that area. The Fund staff had felt in keeping with its efforts to strengthen surveillance, its projections for exports should be made more conservative.

Regarding the investment program and the fact that the incremental output ratio was relatively high, one important recent adjustment was a reduction in the investment to GDP ratio, the staff representative explained. In the early 1980s, the level of investment had reached almost 30 percent of GDP, because very large--although not very productive--investments had been made in the infrastructure. One of the main concerns behind the adjustment program worked out with the World Bank in 1985 was to stabilize the overall investment effort, with a view to containing investment and concentrating on the most productive areas. The authorities had since reduced the level of investment to about 20 percent of GDP without hampering the country's growth prospects. In fact, there had been an acceleration of growth in 1985 and 1986, owing to better climatic conditions. Mauritania had been relatively fortunate in obtaining large amounts of concessional assistance, and the investment program was consistent with the improvement in external finances.

The need to take regional developments, such as producer prices in neighboring countries, into account had been one of the concerns involved in the design of the program supported under the stand-by arrangement and the structural adjustment facility, the staff representative continued. Adjustments in 1985/86 in agricultural producer prices had been made in light of the prices in Senegal and other countries. There had been relatively large exchange rate fluctuations in 1986-87, which had affected the price differential between Mauritania and Senegal, and the fluctuations had not been easy to correct quickly, because it was difficult to determine whether bilateral exchange rates might have been reversed. The rate of inflation the authorities had reported for the first seven months of 1987 was higher than the rate given in the staff report, the staff representative noted. There had been a strong acceleration in the rate during May, June, and July because of a meat shortage. However, the authorities had been able to reverse that acceleration through an improved supply policy, so that in August 1987 the price index declined sharply. The rate of inflation for 1987 as a whole was expected to be 7 1/2 percent, because of the larger than expected exchange rate depreciation, particularly in relation to bilateral exchange rates, which were important to trade and, therefore, had a significant effect on domestic prices. The authorities should be encouraged to pursue financial policies that would be tight enough to ensure that the impact of exogenous developments would not be accommodated. There had been some difficulty in controlling the banking system float during the first six months of the restructuring of the banking system, but that problem had been corrected.

The annual growth rate for 1987 had been somewhat lower than the program had envisaged, primarily as a result of some technical production difficulties that had been experienced in the mining company, which carried a large weight in the total value added, the staff representative continued. The effects of those difficulties had been offset somewhat by agricultural production, which had performed well owing to favorable climatic conditions, appropriate producer prices, and an increase in fish production. In addition, the local value added had increased as planned under the adjustment program.

An important reform of the pricing system was under way, the staff representative from the African Department noted. The pricing system was relatively complicated and included two types of price controls: some domestically manufactured products were subject to maximum mark-up over cost, set by the manufacturers themselves, while the prices of others were administered by the authorities. Under the system of fixed mark-up over costs, prices were monitored on the basis of a fixed margin over the production cost. However, that system was being phased out, because it was uneconomical and hindered most domestic industries. Although price controls still remained on eight main products, the authorities were committed to phasing out, with World Bank assistance, controls in favor of a more flexible system of export price supervision as soon as enterprises' cost accounting became more reliable.

Mr. Mawakani said that the Mauritanian authorities were committed to the adjustment program, and, in spite of limited resources, significant progress had been made toward achieving economic and financial objectives. The assistance that they were requesting from the Fund and others would be crucial to restoring a viable balance of payments position and laying the groundwork for lasting economic growth.

Two important factors could increase the cost of adjustment in Mauritania, namely, low rainfall and a decline in the world price of iron ore, Mr. Mawakani remarked. To deal with the former, the authorities had invested heavily in irrigation projects, especially the two dams on the Senegal river, which are expected, together with other policy measures in the agricultural sector, to help alleviate the food problem, reduce food imports, and contribute to an improved external balance.

The authorities could not do much about the world price of iron ore, Mr. Mawakani added. They were completely at the mercy of the international market. A recession in the industrial world would have serious effects on the Mauritanian economy and on the effort to restructure and improve the growth prospects. Therefore, the authorities could only hope that industrial countries would follow economic policies that would be conducive to growth and increased world trade. The Mauritanian authorities would do their best to remove the structural rigidities that hindered their economy.

The Acting Chairman made the following summing up:

Executive Directors generally concurred with the thrust of the appraisal in the staff report for the 1987 Article IV consultation with Mauritania; thus the summing up will highlight the main points that were emphasized. Directors commended the authorities for the strong adjustment measures implemented since early 1985 under Fund-supported programs. Directors noted that the improvement in the external accounts was accompanied by a favorable growth performance in 1986 and a reduction in the rate of inflation. Directors welcomed the decisive supply-side measures introduced by the Government. These included the depreciation of the real effective exchange rate; strong actions to put the iron ore company on a sound financial footing; similar actions to restructure and privatize other public enterprises; the rehabilitation and partial privatization of the banking system; and the liberalization of prices and imports.

Directors generally endorsed the authorities' growth-oriented strategy based on a prudent demand-management stance; and the structural reforms directed at improving efficiency in the use of public sector resources, and at promoting private sector activities. Directors observed, however, that despite the gains achieved in recent years and the prospective improvement in the fiscal and external positions, the economy remains fragile and dependent on concessional aid flows, because of the limited productive basis, and because the external financial imbalances remain large. It was also noted that after the favorable results in 1986, the growth rate had slowed in 1987, and that inflation was above target. Under the circumstances, Directors stressed the need for a continuation of firm demand and structural adjustment policies for a number of years, to improve the external position and reduce the debt service burden, while improving the use of resources, achieving and sustaining adequate growth, and containing inflation. In that connection, they welcomed the intention to limit public investment to about 20 percent of GDP with the emphasis on the rehabilitation of the infrastructure, and the absence of commercial bank financing of the public sector. They also welcomed the adoption of a three-year rolling investment program and strengthened project selection. In the area of structural reforms, they encouraged the authorities to further pursue the price and import liberalization policy, to complete the banking sector restructuring, and to carry out the tax and tariff reforms which have been initiated.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision in concluding the 1987 Article XIV consultation with Mauritania, in the light of the 1987 Article IV consultation with Mauritania, conducted under Decision No. 5392-(77/63), adopted April 29, 1987, as amended (Surveillance over Exchange Rate Policies).

2. Mauritania maintains the restrictive exchange measures described in EBS/87/218, in accordance with Article XIV, Section 2, and none of these measures is subject to approval under Article VIII.

Decision No. 8725-(87/154), adopted
November 6, 1987

Review Under Stand-By Arrangement

1. Mauritania has consulted with the Fund in accordance with paragraph 4(d) of the stand-by arrangement for Mauritania (EBS/87/73, Sup. 1, 5/7/87) and paragraph 3 of the letter from the Minister of Economy and Finance and the Governor of the Central Bank of Mauritania dated February 24, 1987, annexed thereto, in order to review progress in the implementation of the program and establish performance criteria on total net domestic credit of the banking system for the remainder of the program period.

2. The letter dated October 2, 1987 from the Minister of Economy and Finance and the Governor of the Central Bank of Mauritania shall be attached to the stand-by arrangement for Mauritania, and the letter dated February 24, 1987 and its annexed memorandum shall be read as supplemented by the letter dated October 2, 1987.

3. Accordingly, the reference in subparagraph 4(a)(i) of the stand-by arrangement for Mauritania to paragraph 15 of the annex to the letter dated February 24, 1987 relating to the limit on total net domestic credit of the banking system, shall comprehend a reference to paragraph 13 of the letter dated October 2, 1987.

4. The Fund decides that the review contemplated in subparagraph 4(d) of the stand-by arrangement for Mauritania is completed.

Decision No. 8726-(87/154), adopted
November 6, 1987

Structural Adjustment Arrangement - Second Annual Arrangement

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

2. The Fund has appraised the progress in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/87/262).

3. The Fund approves the arrangement set forth in EBS/87/218, Supplement 2.

Decision No. 8727-(87/154), adopted
November 6, 1987

3. KINGDOM OF THE NETHERLANDS - NETHERLANDS ANTILLES - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with the Netherlands Antilles (SM/87/242, 10/16/87; Cor. 1, 10/21/87; and Cor. 2, 10/22/87). They also had before them a background paper on recent economic developments in the Netherlands Antilles (SM/87/244, 10/22/87).

The staff representative from the European Department said that the budget deficit for 1987 was expected to amount to NA f. 9 million, instead of NA f. 15 million, as had been reported on page 6 of the staff report. However, the change was so small it would not significantly affect either the medium-term projections contained in the staff report, or the staff's conclusions.

Mr. Posthumus made the following statement:

The authorities wish to thank the Fund staff for the collaborative and fruitful way in which they have carried out the 1987 Article IV consultations. My authorities highly appreciate this opportunity to let their economy be known to, and their policies judged by, the international community.

The pillars of the Netherlands Antilles economy were all affected by adverse external developments in the early 1980s: the fall in oil prices triggered a devaluation of the bolívar with severe consequences for tourism, and the refineries on Curacao and Aruba--Aruba became a separate entity within the Kingdom of the Netherlands effective January 1, 1986--were closed, and the Curacao refinery was reopened by a different operator at a sharply reduced income level. In addition, transshipment and dry dock activities felt the influence of the adverse oil market developments. The repeal of U.S. withholding taxes, and changes in tax treaties with the United States and the Netherlands diminished the attractiveness of the Netherlands Antilles as an offshore financial center.

The impact of oil market developments on the external and fiscal balances has until recently been compensated for by temporary receipts from the termination of refining activities and backpayments of offshore taxes. The greatest impact of the decline in offshore financial activities will be felt in the near future.

Prosperity in the years before the oil price declined led to higher wage costs, income redistribution, and labor market rigidities. The early response to adverse external developments resulted in higher public sector spending rather than adjustment to a lower revenue level. However, adjustment is now under way, and measures have been taken to strengthen public finances, increase competitiveness, and promote tourism and new activities. The example of the refinery shows that wage costs can be reduced with highly visible results.

The authorities agree with the staff appraisal and recognize that much more will have to be done. Additional budgetary measures will be needed to avoid further rapid debt accumulation. Measures to limit public sector staffing levels and wages are clearly preferable to additional revenue raising. Real wages in the economy will have to be adapted to the new environment. It is clear that labor market rigidities will have to be addressed as well.

Monetary policy will continue to be geared toward maintaining the fixed parity with the dollar. My authorities do not see a role for a devaluation as part of the adjustment process. They attach great importance to the exchange rate's function as a nominal anchor and in bolstering confidence. They are well aware that this policy stance makes decisive and timely domestic measures all the more essential.

Both the Central Government and the island Governments are committed to taking further measures along the lines outlined by the staff. At the same time, they recognize that some difficult obstacles will have to be overcome. The favorable transitory flows mentioned above have not made it easier to agree on timely measures. It is politically difficult to change labor market regulations and adjust wage levels, especially when they are applied selectively. It will be imperative to exploit, as much as possible, the comparative advantages of the Antillean economy: a well-educated labor force and a good infrastructure, which will continue to be supported by sizable Dutch aid flows.

Mrs. Walker made the following statement:

The authorities must respond decisively and quickly to the adverse conditions facing their economy, if they are to avert even more difficult conditions in the future. While the impact of external developments on the economy has been softened by helpful transitory measures taken in the fiscal area, their effect will be only temporary. A comprehensive program is necessary to simultaneously attack the fiscal deficit, improve the Government's efficiency and productivity, and bring about economic development and diversification. In this regard, I welcome the fact that the authorities recognize that additional action must be taken.

I agree with the staff that the authorities should devise a plan for reducing the fiscal deficit that does not rely on quick fixes, but instead addresses the structural weaknesses of the Government, particularly in the civil service and public utilities. The adoption of such a plan would also help restore confidence in the Government's actions and would probably improve the investment climate. Measures must be taken to reform the civil service, first by removing redundancies of employment in those divisions where overemployment is the most pressing problem, and then by reducing wages where they are the most out of line. In this regard, it would be preferable to take the time made available by the favorable transitory measures to restructure the civil service pay scale to be more reflective of priorities and to promote job motivation. Such a course of action--which is tailored to specific problem areas--would be a more effective and efficient way of bringing about a desired reduction in the civil service wage scale.

Additional scope for improvement in the public sector could be obtained through elimination of the duplication and overlapping of activities at the two levels of government. There is also room for improvement in budgetary procedures, and the staff should elaborate on how this might be accomplished. Reductions in subsidies to the public utilities and efforts to make them more efficient will be an essential part of the fiscal effort. Furthermore, a comprehensive appraisal of the public finances should include a review of the financial position of the pension scheme and the social insurance system. Arrears in these two schemes should not remain the source of financing for government expenditure.

In addition to significant action to correct the fiscal deficit, action must be taken to improve competitiveness. In my authorities' view, rigidities in the labor markets are a serious impediment in this regard. Action to relax the regulations regarding employment, including hiring, firing, and redundancy contracts, as well as regulations involving wage indexation and minimum wage laws, would contribute to improved competitiveness through lower wage costs. The general investment climate would also be improved if these regulations were relaxed and requirements for registration of companies and other detriments to foreign investment were removed. A reduction in wage costs could also be improved through changes in the public utilities to make them more efficient. Removal of the recently introduced protectionist measures would aid the investment climate and would facilitate the adoption of a concrete plan of action on the fiscal front.

I understand the authorities' position on further devaluation. However, it is clear that if this policy is to succeed, decisive and urgent action must be taken on the fiscal front; without such action, the drain on foreign exchange reserves will place pressure on the exchange rate. In this regard, I urge the authorities not to be complacent amidst the reprieve in their fiscal problems, but instead to correct the fiscal and external imbalances and establish a base for economic development that will provide growth in the future.

The staff representative from the European Department said that the staff would like to see an upgrading of the mechanisms used to record budgetary expenditure and revenue. As the staff had reported, audited data were available only through 1984, and all the information from that time on was based on budgetary data that had just been carried forward without incorporating any specific information on what had actually happened during the intervening years. As a result, there was a substantial difference between what was contained in the budget and what was being carried forward in the program. Clearly the expenditure and revenue recording mechanism had to be updated as a top priority, because it would be impossible to design any meaningful budget for the future on the basis of data that had been estimated for the past two or even three years. In addition, an upgrading of the budgetary decision-making process itself was needed, particularly the holding of budgetary discussions on a regular basis, so that budget appropriations and decisions were not taken only very late in the year.

Mr. Posthumus said that he agreed with Mrs. Walker's statement. As he understood it, the Board agreed with the staff report.

The Acting Chairman then made the following summing up:

> Executive Directors, taking note of the statement made by Mr. Posthumus, broadly agreed with the thrust of the staff appraisal in the report for the 1987 Article IV consultation with the Kingdom of the Netherlands - Netherlands Antilles.
>
> It is expected that the next Article IV consultation with the Netherlands Antilles will take place on the two-year cycle.

4. ARGENTINA - REPORT BY MANAGING DIRECTOR

The Chairman said that the management and staff had recently held informal discussions with the Argentine authorities on their economic program. Following his discussion with the head of the Central Bank on November 6, 1987, he was in a position to inform the Board that an agreement on economic policies had been reached which would make a continuation of the stand-by arrangement possible.

The Executive Directors took note of the Chairman's statement.