

MASTER FILES
ROOM C-130

0404
INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/151

10:00 a.m., October 30, 1987

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

Executive Directors

A. Abdallah

M. Finaish

Mwakani Samba
Y. A. Nimatallah

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K. Yamazaki

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J. Prader
H. S. Binay, Temporary
M. Hepp, Temporary

B. Goos
D. V. Nhien, Temporary
J. Hospedales
M. Foot
D. McCormack
G. D. Hodgson, Temporary

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M. Fogelholm
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V. Rousset, Temporary
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I. Sliper, Temporary
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A. Vasudevan, Temporary

S. Rebecchini, Temporary

L. Van Houtven, Secretary and Counsellor
V. Wall, Assistant

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Also Present

IBRD: H. W. Messenger, Roger V. Key, Africa Regional Office. African Department: M. Allen, J. Artus, D. T. S. Ballali, E. L. Bornemann, A. Bourhane, E. A. Calamitsis, J. Harnack, J. G. Keyes, S. N. Kimaro, T. P. McLoughlin, J. D. Simpson. European Department: M. Russo, Director; B. E. Rose, Deputy Director. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; A. Ariyoshi, E. Brau, A. Chopra, H. Hino, H. B. Junz. Fiscal Affairs Department: H. Bierman. IMF Institute: W. Ufwinki, P. Non, Participants. Legal Department: H. Elizalde, A. O. Liuksila, J. V. Surr. Secretary's Department: C. Brachet, Deputy Secretary. Treasurer's Department: D. V. Pritchett, G. Wittich. Bureau of Statistics: M. H. Le Marois. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, P. D. Péroz, P. Péterfalvy, G. Pineau, D. C. Templeman. Assistants to Executive Directors: O. S.-M. Bethel, R. Comotto, G. K. Hodges, S. King, K.-H. Kleine, M. Kyhlberg, V. K. Malhotra, T. Morita, C. Noriega, W. K. Parmena, L. M. Piantini, S. Rouai, D. Saha, G. Schurr, H. van der Burg, R. Wenzel, I. Zaidi.

1. TANZANIA - REVIEW UNDER STAND-BY ARRANGEMENT AND
STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered a staff paper on the second review under the 18-month stand-by arrangement for Tanzania (EBS/87/213, 10/8/87), together with a staff paper on Tanzania's request for arrangements under the structural adjustment facility (EBD/87/250, 10/6/87).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their October 20, 1987 discussion in Committee of the Whole of a paper entitled "Tanzania: Policy Framework Paper 1987/88-1989/90."

The Executive Directors of the Bank and IDA discussed on October 20, 1987, in a meeting of the Committee of the Whole, the paper entitled "Tanzania: Policy Framework Paper 1987/88-1989/90."

While expressing misgivings about the report's perceived lack of precision in description of further reforms to be taken, Directors supported the Government's comprehensive adjustment program and commended the Government for the policy measures that had already been taken. Directors commented in particular on the substantial adjustments in the exchange rate, the increases in interest rates, the reduction in the extent of price control, the maintenance of fiscal and monetary stability, and the increases in agricultural producer prices. It was noted that these measures are already having a positive impact on the growth of the Tanzanian economy.

Directors stressed the importance of continuing the program but were concerned about the lack of specificity of the measures outlined in the policy framework paper. Directors urged that specific measures necessary to maintain the momentum of the program be developed as quickly as possible. It was emphasized that these measures would need to include further adjustment of exchange rates and interest rates, improved efficiency of the parastatal sector, increases in revenues, and improved public expenditure management.

Directors emphasized the need for further improvements in the efficiency of the agricultural marketing system. The need to reform the financial sector and to alleviate transport bottlenecks was also emphasized.

Directors recognized that in the medium term the program should be beneficial to all groups in Tanzanian society but were concerned as to whether the short-term social costs of adjustment were being adequately addressed. Directors mentioned in particular the effects on the urban poor and the deterioration in basic social services. In response, staff emphasized that mitigating the social costs of adjustment remained high on the Government's agenda. Most of the poor lived in rural areas and would benefit directly from the program while the urban population generally retained close links with the farming sector. Staff also noted that the ongoing work on population, health and nutrition, and public expenditure would contribute to concrete measures to strengthen social programs.

Directors discussed the growth and balance of payments scenario. They endorsed the 4 percent GDP growth but were concerned about the high budget deficits and current account deficits that were expected to prevail through the remainder of the 1980s. They were also concerned as to whether the supply response would be adequate to generate the projected rapid growth in exports. Directors recognized the need for additional external assistance including balance of payments support as well as further debt rescheduling.

Mr. Abdallah made the following statement:

The program under the structural adjustment arrangement is a logical extension of the authorities' first-year Economic Recovery Program (ERP) launched in 1986 and supported initially by the stand-by program and the World Bank's multisectoral rehabilitation credit since the main obstacles now being encountered are essentially structural in nature and no longer of a demand-management character. As the staff has explained in the two papers before the Board today, during the first year of the ERP, 1986/87, the authorities registered considerable progress in reviving the economy as demonstrated by an increase in the GDP growth rate from an annual average of 1.2 percent over the previous three years to an estimated 3.5 percent, without exacerbating the rate of inflation despite considerable and continuing real effective exchange rate depreciation and tremendous progress in price deregulation.

The authorities have now entered a stage in the ERP where they are focusing on the medium-term objectives--namely, the attainment of a 4 percent annual GDP growth rate with effect from 1987/88 and for the rest of the program while beginning to bring down the rate of inflation from 30 percent at the end of this year steadily to 8 percent by 1989/90. In the external sector, the combined effects of the structural measures, together with tighter fiscal and monetary policies and the continuation

of a flexible exchange rate regime, are expected to transform the large underlying balance of payments deficits progressively to an overall surplus by 1991.

The nonobservance of some performance criteria in June, 1987 relating to credit ceilings, is rooted in structural bottlenecks arising from crop marketing and processing and other industrial activities which are being fully addressed under the structural adjustment facility program as elaborated below. In June the stand-by program also encountered two minor slippages: the accumulation of external payments arrears of \$2.7 million and a shortfall in the required annual reduction of payments arrears of \$2 million or a reduction of \$48 million instead of \$50 million. The authorities decided to proceed with program implementation while completing the second review and undertook to comply with new performance criteria now established for the end of October.

With regard to the structural adjustment facility program, the authorities have formulated concrete structural measures covering the first year of the program 1987/88 in the field of marketing, production and transport, fiscal and monetary policies, and exchange rate regime. As far as the following two years are concerned, the preparation of policy papers and studies are under way in collaboration with the World Bank and the Fund with the specific objective of attaining the authorities' Economic Recovery Program targets stated earlier. The observations of some Executive Directors of the World Bank that the thrust of the structural reforms was in the right direction but that they were "concerned about the lack of specificity of the measures outlined in the policy framework paper," were based on incomplete information, relying, as they did, only on EBD/87/250. If one reads that paper in conjunction with EBS/87/213 and in particular the Minister's letter of intent addressed to the Managing Director, in Attachment I, he will get a complete picture including the specific measures which will be taken in 1987/88.

For instance, in the field of marketing, the authorities will, during 1987/88, encourage the marketing of foodgrains by cooperative unions and private traders. The main structural change, which had far-reaching consequences on credit ceilings as mentioned earlier, is that from the current fiscal year the National Milling Corporation (NMC) will serve essentially as a buyer of last resort. Until recently (1984/85) NMC was the sole buyer as it had the monopoly of marketing and distribution of all foodcrops, a role which of late had caused NMC serious problems in clearing its stocks as the marketing channels became diversified. In addition, the new marketing policy of NMC will be to set the buying and selling price so as to ensure the avoidance of losses.

For continued recovery of the agricultural sector, the authorities continue with their long-standing policy of increasing producer prices of export crops in real terms. Accordingly, for 1987/88--assuming an average CPI of 25 percent--the producer prices of coffee and tea have been increased in real terms by 5 percent, tobacco by 3-5 percent, and cashew nuts by 40 percent. The producer price of cotton was raised by a nominal 15 percent pending further review of its prospects as well as what shall be done with the losses of the Tanzania Cotton Marketing Board.

Under the first year of the Economic Recovery Program the industrial sector recovery was sluggish with capacity utilization remaining low. Under the structural adjustment program the authorities intend to employ an efficient allocation of foreign exchange to provide raw materials and spare parts selectively to those subsectors with potential for less dependence on imports and greater backward linkage. The Government is currently working in collaboration with the World Bank to develop an action program to restructure the manufacturing sector. Rehabilitation of the capital stock is the main priority of the public investment program and in view of this, pre-eminence in funding will be given to both industrial and transport sectors. The latter will require considerable and sustained external assistance for rehabilitation, modernization, and maintenance of the country's ports and harbors, and also the railway and road networks which are in a very bad state of disrepair. Under the 1987/88 program the process has started with the implementation of an emergency relief and rehabilitation program while a national transport policy paper has just been completed.

In the wider field of public finance and fiscal policy the program aims at fostering efficiency in resource allocation and utilization. To this end the rehabilitation of public enterprises by way of strengthening management and rationalizing operations initiated in 1984/85 will be continued in collaboration with the World Bank. In addition, the Government will prepare an action program by the end of 1987/88 for implementation during the final two years of the structural adjustment arrangement.

Fiscal policy during the three years will aim at consolidating the achievements attained in 1986/87 to hold the budgetary deficit at 13 percent of GDP, a level which can be covered with external financing, in order to make room for domestic bank financing for productive sectors of the economy. In fact, however, the fiscal policy will be so tight that it will permit only ongoing projects and those absolutely required for rehabilitation in 1987/88. Under the structural adjustment program the authorities will aim at diversifying and improving financial and banking services. Accordingly, a study of the financial system along these lines will be completed and discussed with the Bank and Fund staff for implementation during 1988/89 and 1989/90.

The authorities are fully committed to pursuing the flexible exchange rate policy that made considerable contribution to the economic revival at the beginning of the Economic Recovery Program until they attain a realistic exchange rate by mid-1988. In particular, they wish to ensure that the exchange rate provides room for incentives for export crops and necessary improvements in the performance of the manufacturing sector. At the same time, however, the authorities have expressed concern about the increasing social burden exacerbated by the pace of adjustment, especially on the urban population and that part of the rural population of small-holder farmers who are beginning to apply modern farming methods with imported equipment and inputs. They point out that the adjustment burden on the upcoming small farmer and cooperatives has been aggravated by the rising level of interest rates which have contributed significantly to the losses incurred by the cooperative sector. These adverse developments on the social fabric cannot be ignored by authorities. The authorities attach considerable importance, therefore, to the forthcoming review due for completion in February 1988 with respect to the assessment of fiscal, monetary, and exchange rate targets. At that time, they also expect to be in a better position to assess progress in overcoming structural obstacles in manufacturing and transportation as their present observations indicate better than anticipated crop production.

In conclusion, let me draw the attention of Directors to the substantial real adjustments which have already been effected in Tanzania within a very short period following a bold decision to move from a central planning system. Admittedly, the process is still incomplete but the distance that has already been covered is immense such that some of the economic agents--including some businessmen--have been thrown out of balance. In fact, some exporters are known to be delaying repatriation of earnings knowing that they will earn more in local currency the longer they wait. Continuing external support and understanding are therefore needed to facilitate a smooth completion of the process.

Mr. Foot made the following statement:

Progress so far under the stand-by arrangement has clearly been encouraging. After rising by only 2 percent in absolute terms in the four years prior to 1984, GDP growth has accelerated. Meanwhile inflation has moderated somewhat despite the exchange rate depreciation. There has been a significant qualitative improvement in the economy as shown by the increased availability of imported goods. Aided initially by good weather, the adjustment program has resulted in more benefits with fewer costs than before.

Despite this generally favorable outcome, some performance criteria have been exceeded owing to the credit demands of the National Milling Corporation. To a certain extent this was a problem of success stemming from the good harvest; but this also reflects continuing distortions in the agricultural sector and, more particularly, in inefficient marketing and an inappropriate pricing structure. The authorities have taken measures to enable the National Milling Corporation to break even in 1987/88. However, there remains an underlying problem that will require a fundamental review of the National Milling Corporation's role and structure in order to ensure that it acts consistently as a buyer of last, rather than first, resort.

The authorities have made further steps toward meeting their commitment to achieving an equilibrium exchange rate by mid-1988. However, the continuing gap between the official and parallel rate suggests that there is probably still some way to go before the equilibrium rate is achieved, the current pace of depreciation being at the low end of what is economically sensible. We look forward to learning of further progress at the time of the next review.

As the Chairman of the Development Committee has emphasized, increased resources for the poorest countries will help only if they are accompanied by economic adjustment and reform. Thus, it was disappointing to see that the policy framework paper did not establish plans for a much further adjustment effort. In fact, it was rather vague in several areas. Furthermore, while the authorities have taken important steps on the structural front, there remain areas where the pace of structural reform could be accelerated--for example, producer prices. In most cases, producer prices for food appear to be adequate; however, the same does not hold true for prices of export crops. The authorities are committed to bringing producer prices to 60-70 percent of export prices, but where prices are below that, they will increase them by 5 percent a year in real terms, a disappointing objective given continuing pressures on the external position.

Similar considerations apply to the trade system. The "own exchange" system seems to have worked well, and the authorities have also completed a review of the tariff system and plan to introduce reforms accordingly. However, the policy framework paper should have given more detailed information on the plans. In general, further trade liberalization would appear to be both necessary and desirable. I hope that additional measures can be taken in step with the exchange rate changes.

Early progress should be made in strengthening the performance of the financial system, in which flexible interest rates will play an important role. Despite increases already put in place under the program, real interest rates remain significantly negative in real terms.

To end on a positive note, the authorities' record of producing what they promise is very good. They are simply reluctant to enter into commitments they cannot keep. Tanzania's problems are significant, and the political balance is still very delicate. However, Fund programs in the country have been quite meaningful. Thus, we should encourage the authorities to build on what has already been achieved.

Mr. Hodgson made the following statement:

Tanzania has made some important early progress under the stand-by arrangement, although the adjustment measures implemented so far have revealed some of the serious structural weaknesses within the economy that urgently need to be addressed. Clearly, much remains to be done before the economy can be placed on a sound footing, and we support the proposals before us today.

On the positive side, the economy has already begun to respond to the large devaluation and to the significant increases in producer prices. Economic agents everywhere respond to more appropriate price signals. It is also noteworthy that despite significant corrections in prices and the exchange rate, inflation has remained at roughly the same level, even as more goods become available within the economy.

However, the program has run into serious problems in the area of credit to the agricultural sector. While it is disappointing that the domestic credit performance criteria have not been met, the overshooting of credit is merely a symptom of a much deeper structural problem within the agricultural marketing institutions. With that in mind, it will be crucial to carry out a comprehensive restructuring of agricultural marketing and pricing policies. Steps are already being taken to give cooperatives and large producers the ability to export directly, and action studies described in the policy framework paper are being conducted for a number of crops. The results of these studies need to be implemented quickly, certainly before the end of the first year of the structural adjustment facility. Similar rehabilitation plans are to be developed in the industrial and transportation sectors. Increased investment in the transportation sector could go a long way toward reducing structural bottlenecks and would have sizable benefits for the whole East African region.

The authorities are entering a more difficult adjustment phase. Policy initiatives already taken must be continued, while the authorities deal with the structural issues. Adequate emphasis has not yet been given to controlling government expenditures. Although the budget for 1987/88 provides for a reduction in the real level of most categories of expenditure, development

outlays may be underestimated, which could lead to a high level of overall spending. As the staff emphasizes, some of the planned cuts, such as in defense spending, may be hard to implement. What contingencies do the authorities have in mind if they have to take action to reach the program's fiscal targets?

The increase in interest rates under the current program has been very welcome. Whether the authorities achieve positive real rates by mid-1988, of course, will depend to a significant extent upon inflation goals being reached, which, in turn, depends upon a renewed effort to stay within the program's credit and monetary targets. While we do not object to flexibility in the credit ceilings for the balance of the program, the new ceilings should be strictly observed by the authorities. Nonetheless, even if the credit and domestic asset ceilings are observed, further modest increases in interest rates may be warranted to ensure that rates do indeed reach real positive levels.

Exchange rate devaluation has been a central element of the adjustment program, and a sizable devaluation has already taken place. Nevertheless, a large gap continues to exist between the official and parallel market rates. We understand the very difficult political circumstances in which price and exchange rate adjustments in Tanzania have been taken, but we feel it continues to be vital to the success of this program that the authorities meet their target of an equilibrium exchange rate by mid-1988. The importance of exchange market unification and related improvements in incentives, fiscal performance, and efficient resource allocation cannot be overemphasized. In fact, even quicker movement to exchange rate equilibrium might be justified. We therefore urge the authorities to keep an open mind on the exchange rate and to appreciate the benefits of devaluation as well as the short-term costs, since the continuing presence of a parallel market is detrimental to Tanzania's long-term interest in stabilization and growth.

Finally, I wonder whether the staff or Mr. Abdallah could tell us of any plans for a follow-up stand-by arrangement. I would also appreciate staff comments on how official debt rescheduling for the coming year might proceed. Continuing Fund support under the stand-by arrangement and the structural adjustment facility are essential elements in Tanzania's adjustment efforts.

Mr. Fogelholm made the following statement:

I approve of the completion of the review of the stand-by arrangement and support the request for an arrangement under the structural adjustment facility.

begin removing existing trade and exchange restrictions." Is it possible to define an equilibrium exchange rate within the framework of trade and exchange restrictions and negative interest rates?

It is easy to see that the external financing cost of gradual adjustment is bound to be much higher than that of a policy of simultaneous liberalization and adjustment of the rate. If we continue to support these inefficiencies by feeding them during some transition period, the structural adjustment we are supposedly seeking may never be achieved. We therefore urge the Tanzanian authorities to take simultaneous actions to remove exchange and trade restrictions and correct the exchange rate and interest rates all at the same time; such policies should help them to obtain the necessary external support for this purpose.

The principal structural adjustment measures proposed in the policy framework paper seem mutually contradictory, because it is difficult if not impossible to assess the efficiency of enterprises when the price system is distorted. However, the first of these measures proposes allocating foreign exchange, giving the first priority to the most efficient enterprises, while the fifth calls for greater reliance on correct price signals. The apparent combining of these two measures into a single system calls for the staff at least to explain how it defines "efficiency" and "correct price signals" within a context of a system of prices and resource allocation mainly determined by the Government.

One of the goals of the program is to reduce the domestic inflation rate from about 30 percent in 1986/87 to less than 10 percent in 1989/90, while moving toward an equilibrium exchange rate. Is this inflation goal achievable using current policies, or do the authorities plan a shock program for containing or freezing wages and prices in 1988 after the exchange rate correction takes place? On the basis of the discussions we have recently had on such programs, it seems unrealistic to assume that such a sequence of policies could successfully be implemented.

Thus, the second review does not indicate a sufficiently clear departure from the policies that have prevented Tanzania from resisting more effectively the deterioration of its external markets. We hope it is not too late to obtain a less gradual reorientation of Tanzania's economic policies; if more vigorous action is taken in the direction of liberalization, better results will almost certainly be obtained, as is demonstrated by the experience of several other countries in similar circumstances.

In conclusion, we are fully aware of the degree of adjustment already achieved in Tanzania, and our remarks are intended solely to persuade the authorities that it would be greatly to their advantage to accelerate the pace of reform.

Mrs. Walker made the following statement:

We welcome the completion of the policy framework paper and structural adjustment arrangement. The program represents a continuation of the macroeconomic and structural reforms Tanzania has already undertaken and strengthens the authorities' commitment to a difficult but necessary adjustment process. We regret that it has taken more than a year since the stand-by arrangement took effect to finalize the policy framework paper, since it should have been a guide for more detailed economic and financial policy commitments contained in the arrangement under the structural adjustment facility, the stand-by arrangement, and World Bank loan programs, as well as a guide for bilateral and multilateral aid flows. In this connection, the policy framework paper could have played a more effective role in donor coordination, particularly with other multilateral development banks such as the African Development Bank. Early consultation with other donors could provide the Fund and the Bank with useful guidance in formulating the policy framework with the country and could help ensure that other loan programs are coordinated with the policy framework objectives.

In spite of the order of events, Tanzania has adopted a comprehensive Economic Recovery Program, having already implemented a number of important measures, and signs of progress are evident. We commend the authorities for the measures they have taken thus far, and we welcome their continued commitment to this difficult process. I note Mr. Foot's point that it is praiseworthy that the authorities have stuck to their commitments. However, as the staff points out, Tanzania is entering an even more difficult stage of adjustment, one which will require continuous and bold action on a number of fronts, particularly in the structural area. Thus, there is no room for slippage; in fact, a speeding up of reforms in certain areas would ensure better prospects for economic recovery. We urge the authorities to pursue with vigor the measures contained in the policy framework paper.

Regarding the review of the stand-by arrangement, we regret that four performance criteria for end-June were not met. However, we are encouraged that measures can be taken to compensate for the targets missed and that the overall program is still on track. It will be very important to monitor developments closely and take early action if deviations from the program's fiscal targets occur, which the authorities successfully did in April.

The adoption of a medium-term public expenditure strategy that meets the needs of the economy, stays within the fiscal constraints, and allows for resources to be applied to priority sectors such as transportation will be important. Furthermore, enhanced monitoring of foreign assistance will be a key element of the process. A review of the parastatal sector will also enhance the prospects for improved fiscal performance of the Government, but we would look toward divestiture as an option under consideration.

Monetary policy appears to be on track. Improving financial resource mobilization will be important to providing needed financial services and credit, particularly to the growing private sector. Therefore, early implementation of an action program in this area will be important.

Progress has been made in improving the agricultural sector owing to a number of factors, including more realistic producer prices. Continued enhancement of incentives for agricultural production, bearing in mind the need to strike a balance between production and demand, as well as improved marketing arrangements are welcome. Increases in the real producer prices for export crops over the next several years will be important to achieving the targeted rate of increase for exports critical to the achievement of balance of payments viability in the medium term. Furthermore, in addition to the improvements already made in marketing, it will be important to continue to enhance the direct role of the private sector in this area. The review of the roles of the marketing boards, cooperatives, and private institutions should aim in this direction. In addition, action must be taken to ensure that the structural problems of the National Milling Corporation are resolved.

We welcome the movement that has occurred in the exchange rate and urge the authorities to maintain a flexible exchange rate policy with substantial progress being made as soon as possible toward the equilibrium rate. An appropriate exchange rate is critical to the overall success of the reform program. In addition, the move to an appropriate exchange rate must be accompanied by removal of exchange and trade restrictions, and we will look toward substantial progress being made on this front, including a timetable for the elimination of the "own exchange" import scheme and the export retention scheme.

Exports are projected to increase substantially in the next year, in spite of significantly difficult infrastructural constraints such as transportation and marketing. While a study has been completed on the transportation system, we wonder whether plans will be made to seriously address this problem in the near future. It appears that regardless of the increase in export production, much may be lost without basic infrastructure to transport the increased exports out of the country.

While the overall balance of payments deficit will be reduced in 1987/88, there remains a financing gap of \$175 million, if the estimates remain accurate. Since \$100 million of this gap may be closed with debt relief already agreed to, if the stand-by arrangement remains on track, \$75 million in additional debt relief must be secured in order for the structural adjustment facility program to be fully financed. As far as we are aware, there is no plan currently in place for rescheduling this \$75 million. Bringing to the Board the first year of a structural adjustment facility program that is not fully financed raises some procedural issues that we think need to be considered. It is our understanding that we have every obligation to ensure that these programs are financed, just as we are with stand-by arrangements. Because of the different program years between the structural adjustment facility and the stand-by arrangement in this case, however, we are faced with a rescheduling gap that must be sorted out with the country, the Paris Club, and the Fund. While it is certainly too late to deal with this issue before we approve the arrangement under the structural adjustment facility today, we would like some immediate clarification of this issue. In addition, we think it is necessary to bring this issue back to the Board in the context of the next discussion on Tanzania. Furthermore, we would like the staff to consider how this situation will be dealt with in general and develop an acceptable approach with the Paris Club.

Finally, we believe that it is critical that the authorities maintain their efforts in every area to keep the adjustment program on track. They have done well so far and we look forward to their continued success.

Mr. Finaish made the following statement:

The adjustment strategy currently being pursued in Tanzania correctly recognizes that the economic and financial problems facing the country require a broad range of policies. The economic adjustment efforts have emphasized both structural reforms and restrictive demand-management policies, and considerable progress has been made in increasing the market orientation of the economy. The task to transform the economy into a more competitive and open economy is not an easy one, and the authorities are to be commended for implementing the significant adjustment measures.

Notwithstanding the relatively favorable recent developments and the fact that the program for 1986/87 was implemented largely as envisaged, the authorities will need to be vigilant in the coming months, not only to ensure continued recovery for the remainder of the stand-by arrangement but also to establish a firm base for sustained improvements in the medium term under

the structural adjustment facility arrangements. With respect to fiscal policy, some of the envisaged cuts in real expenditure may prove difficult to effect and the staff has emphasized that the authorities should stand ready to take prompt remedial action if necessary. We welcome the authorities' intention to review annually the magnitude of the investment program and its composition in order to ensure consistency with the available financing and to effect a reallocation of resources toward priority sectors such as transportation. Also welcome is the authorities' commitment to implement monetary and credit policies consistent with the objective for economic growth, the balance of payments, and the rate of inflation. We have noted that the authorities will continue their policy of adjusting the exchange rate in real effective terms and have reiterated their intention to establish an equilibrium exchange rate no later than mid-1988. However, we appreciate the concern expressed by the authorities--and noted in Mr. Abdallah's helpful statement--about the increasing social burden caused by the pace of adjustment, especially on the urban population and small farmers who are beginning to apply farming methods that make use of imported equipment and inputs.

On the whole, we are in agreement with the staff appraisal and the course of adjustment policies that has been set. In particular, the three-year policy program presented by the authorities in support of their request for a structural adjustment arrangement is comprehensive and designed to correct the structural problems and the financial imbalances in the economy. However, I have a specific point on monetary developments for some elaboration by the staff. The staff has noted that monetary policy for fiscal year 1987/88 will be tight, with monetary expansion limited to 10 percent, compared with the target for real GDP growth of 4 percent and a rate of inflation of 25 percent. This has some implications for velocity, and indeed one finds that velocity defined as GDP relative to M2 was stable from 1983 to 1986 but is estimated to increase sharply in 1987 and will continue to rise during the next three years. This is puzzling because in an increasingly monetized developing economy one would have expected the reverse. Furthermore, inflation is expected to decline, interest rates on savings deposits have increased sharply, and the exchange rate has depreciated and will reach an equilibrium level over the next several months, so that domestic financial assets should become relatively attractive to hold. Under these circumstances, the expectation would be for an increase in the demand for money. Some comments from the staff as to why velocity has increased markedly and will continue to rise would be appreciated. The staff's assumptions regarding velocity clearly have important implications for output and inflation.

I would just like to add that we support the proposed decisions.

Mr. Hogeweg made the following statement:

I welcome the progress that has been made by the authorities of Tanzania and their commitment to their program. This commitment is of course essential. Adjustment does take time, and I realize that in the circumstances of Tanzania there are limits to the pace of realistic and workable adjustment.

I welcome the redefinition of the role of the National Milling Corporation, designed to enhance the role played by the private sector and to prevent in future the kind of problems experienced recently. A larger than envisaged crop financing lay at the root of the credit ceilings having been exceeded by wide margins. In this connection I was wondering what the impact on future monetary policy is likely to be of the large amount of credit outstanding to the National Milling Corporation. Also, the staff is right in stressing the importance of the setting of producer and procurement prices for maize and other grains at levels that are consistent with the new role of the National Milling Corporation as a buyer of last resort. What exactly are the circumstances in which this new role would be activated and is there a risk that circumstances may develop in such a way that nevertheless many more funds will be needed for crop financing than envisaged?

With regard to incentives for producers of export crops, I understand the Government is committed, during the three-year program, to raise prices or to ensure a real annual increase of 5 percent, whichever is higher. Raising these prices relative to export prices, apart from raising output, evidently helps to channel a greater part of these exports through official markets. The policy to ensure 5 percent real annual price increases for producers, even if that would distort the envisaged relationship to export prices, seems to carry risks, however. In the extreme, sharp decreases in world market prices would lead to large marketing losses. Maybe the staff could comment on this policy and on whether this risk is a real one. Also, it seems to me that raising nominal prices by a certain percentage in order to achieve a certain real increase, given an expected inflation rate, would tend to firmly build this expectation into the system.

In the same field, the relationship between exchange rate policy and pricing policy for export crops is not entirely clear to me. In determining which price level is equal to 60-70 percent of export prices, a certain exchange rate will have to be used. At the same time further depreciation is envisaged which should change export prices relative to import prices. How are the two combined?

Finally, on exchange rate policy, Tanzania has certainly come a long way toward an exchange rate level that represents an equilibrium. I understand there will be a review, due to be completed in February, to assess the magnitude of the residual adjustment needed to ensure attainment of the objective to reach an equilibrium rate by mid-1988. I attach great importance to this review which should make clear at what level that equilibrium should be and what time schedule should be used to reach it. I understand the authorities also attach great importance to the review, but in this context the adverse short-term impact on the social fabric of the adjustment program is stressed. While I appreciate the importance of the impact on income distribution of adjustment, I noted that the staff appraisal does not mention it in this connection. I would stress the importance of making the adjustment as soon as possible.

I was intrigued by the final sentences of Mr. Abdallah's opening statement. I think exporters behave perfectly rationally when they delay repatriation of earnings, assuming that the exchange rate will depreciate further. This is a classic case in which speculation against their own currency can only result in profit and that shows two things: maybe for the last part of the way toward an equilibrium exchange rate, a large leap is better than a gradual slide. In addition, it illustrates the importance of positive real interest rates on domestic financial assets.

In sum, Tanzania has made a good start during the first year of the program. The medium-term outlook remains, however, fragile, and Tanzania will continue to rely heavily on concessional assistance. A tight adherence to the adjustment policies, and a speeding up of their implementation, are therefore clearly warranted.

Mr. Al-Assaf made the following statement:

I have already expressed my support for the policies being followed by the authorities on the occasion of the Board's discussion of the Article IV consultation with Tanzania and the first review of the current stand-by arrangement. I welcome, therefore, the additional assistance now being proposed under the structural adjustment facility, and I can approve the decisions before us.

It is particularly satisfying that the authorities have reaffirmed their commitment to the basic goals of the program and that barring some unforeseen difficulties, drawings will soon resume under the current stand-by arrangement.

The need to continue the present policy of a flexible exchange rate is essential. In view of the present imbalances

in the external accounts, the achievement of an equilibrium exchange rate should be seen as one of the key objectives of the program.

The current liberalization of marketing arrangements for agricultural commodities should be pursued actively, and it should be seen as complementing the action taken in the area of the exchange rate, inasmuch as it would lead to an increase in the supply of export crops.

The question of the deterioration of the infrastructure of the country, especially in the transportation sector, should be addressed forcefully. In contrast with the two previous issues, this problem cannot be solved in the short term. It will also require extensive external support. This is obviously an area in which the World Bank will play a key role, as it has indicated. I therefore welcome the information that will be provided by the Bank on the scope of this rehabilitation program, especially in the context of the donors' meeting scheduled for next December on this subject.

I would like to express my support for the efforts undertaken by the authorities. The process of adjustment now under way has reached a delicate stage where the measures already taken have not yet had time to produce all of their positive effects. Maintaining the momentum of the program in the months ahead will require determination and courage. I am looking forward to our next review.

Mr. Goos made the following statement:

While the major program objectives have been met so far, performance in some important policy areas was less than satisfactory, notably in regard to domestic credit expansion and the associated continuing difficulties with marketing arrangements and agricultural pricing. The potentially negative effects of the policy slippages in those areas on the eventual success of the stabilization effort can hardly be overemphasized, especially since the authorities are moving into an even more difficult phase of the adjustment process, as pointed out by the staff.

Continued major slippages would be anything but helpful in maintaining the confidence of external creditors in Tanzania's policies and could therefore affect the availability of foreign financing that is essential in the authorities' medium-term planning. Aside from the confidence question, I wonder whether the authorities should not aim at a lesser reliance on external financing than is actually envisaged in the policy framework paper. At the moment, it might be reasonable to expect that the

necessary funds will be available, but given the usual uncertainties surrounding such medium-term expectations, the authorities might be unduly mortgaging their longer-term prospects for growth. I, therefore, would strongly recommend aiming at lower budget and current account deficits than provided for under the policy framework paper. Accordingly, the authorities should step up, to the extent possible, their efforts to increase domestic savings and to improve the efficiency of resource allocation in the years ahead, a point that was also stressed by the World Bank's Committee of the Whole.

In this regard, I should welcome especially the efforts to contain government expenditure, to move toward more realistic levels of real interest rates, and to put into effect the policies for structural reform. While considerable progress has already been achieved in those areas, the authorities should make use of any opportunity to improve the situation beyond the program's projections. In this context, I am particularly concerned about the considerable shortfall that is being expected for 1986-87 in the Central Government's current savings performance, which is supposed to deteriorate considerably under the program projection for 1987.

Much more attention should be paid to developments, or rather improvements, in the savings performance of the Government, which, after all, is of strategic importance for the underlying strength of the economy. Also, in all staff papers, we should attach more importance to the current account position of the fiscal sector in general, particularly in countries that rely to a considerable extent on grants and concessional external lending. Often the figures presented in staff papers on fiscal imbalances are too highly aggregated to allow an assessment of underlying fiscal developments. If appropriate external financing is forthcoming, it certainly should be used for investment as long as it is assured that it is efficiently used. But the main point is that rather than looking at the overall fiscal deficit, it is current savings that show whether or not there is progress in the fiscal position.

In the case before us, I wonder whether the authorities should not strive for additional savings by further cutting wage expenditures. To be sure, important progress has been made in this regard by freezing public employment, and this progress has certainly to be assessed against the background of the previous employment policy pursued in the public sector. But I wonder whether the time has not come for actually reducing public sector staffing, be it only through attrition. Part of the resulting expenditure savings could be used to increase compensation for senior civil service staff with a view to improving morale and, subsequently efficiency in the civil service, which is badly needed at the moment in order to implement reform policies.

On structural policies, I associate myself in particular with the previous speakers who have emphasized the particular importance of appropriate agricultural pricing policies, efficient marketing arrangements, and the need to restore expeditiously a competitive exchange rate.

To conclude, Tanzania is moving in the right direction. While there are a number of areas for more decisive progress--particularly in view of the difficult overall economic situation of the country and its growth objectives--I acknowledge the point made by Mr. Abdallah on the difficulties involved in moving from a centrally planned economy to a market-oriented system. At the same time, I feel greatly encouraged by the authorities' commitment to maintain their adjustment course, and I am confident that the appropriate solutions will be found in the framework of the close cooperation with the Fund and the Bank that is being pursued by Tanzania. On the financing gap, I share the concerns expressed by Ms. Lundsager, and I am looking forward to the staff's response.

Finally, I would like to support the staff appraisal and the proposed decisions.

Mr. Vasudevan made the following statement:

We have looked at the request for the structural adjustment facility principally as a logical development of the stand-by arrangement, which expires early next year, and the World Bank sectoral credit.

In the context of Tanzania's recent rigid and centrally controlled economy, we are encouraged to note that practically all policy-based performance criteria have been observed. The one noteworthy instance of slippage in achieving quantitative targets has been largely occasioned by a good agricultural supply response to the very reform effort under way. Although the situation reduced the productive sectors' access to bank credit, there was a reduction of the rate of increase in prices.

Nevertheless, the role of the National Milling Corporation will have to be limited as, according to the Finance Minister, "problems faced by the National Milling Corporation would seriously endanger the progress of the program in 1987/88." Addressing this matter is urgent, and we have noted the additional steps taken. In this context, there are two points worth considering. If the National Milling Corporation's role is that of buyer of last resort, a question arises as to how the warehousing and storage facilities built up previously will be deployed. Would it be appropriate to lease or sell these to the other

agents who have entered the market? Also, do similar considerations prevail for the milling activity? Is it possible that this function is preserved and further developed by the National Milling Corporation?

In the area of producer prices, especially for grains, we would urge that floor prices, input costs, and producer margins be continuously reviewed so as to maximize the efficiency of the supply response. The entry of the cooperatives into the market for grains is perhaps worthy of being flagged for close review. Increased government patronage of the cooperatives can create problems as bad as the ones the authorities are currently trying to solve.

The comprehensiveness of Tanzania's adjustment effort, the authorities' continuing resolve, and the degree of success achieved have greatly increased the country's creditworthiness, as has already been recognized by the official donor community. Foreign aid financed most of the budget deficit and has reduced the balance of payments financing gap as compared with the medium-term projections made early this year. We agree with Mr. Abdallah that the stabilization gains should be consolidated through growth-oriented adjustment. The authorities should be commended for the efforts made to retain public confidence in the program and policies. However, the public should be able to look forward to per capita income growth, increased employment, and increased supplies of incentive goods.

In this context, we agree with the current emphasis in the investment program on rehabilitation of infrastructure to relieve bottlenecks and increase utilization of existing capacity. The potential for quicker payoff and the immediate scope for rapid absorption of aid are not merely encouraging signs for the donors but would also underline the imperative need for quick disbursements of credits that are pledged.

As I mentioned earlier, the structural adjustment facility program should be viewed in the context of the ongoing reform. We recognize the authorities' continued commitment in the further notable progress made with respect to the exchange rate, inflation, interest rates, the revenue effort, price and wage policies, and the reduction of debt.

In the context of fiscal discipline, it is natural that attention should be focused on new investment that could provide a sustained impetus to growth, although the rehabilitation effort currently has to take priority. But, in a very real sense, this very fact argues for continued urgency of implementation of the program on schedule. Its strong implementation, and the achievement of targeted growth along with improved internal and external balance will provide the basis for a stronger

domestic effort in savings and investment. A strong contribution could be made as a result of the reform of the public enterprises, both in fiscal savings and greater availability of bank credit to the nonpublic enterprise sector. Admittedly, it may be premature to think of a comprehensive policy on public enterprises. However, it would be helpful to begin developing policy in this area.

Tanzania's programs and policies deserve the continued support of the donor financial community, and we would urge an early conclusion to the question of rescheduling past debt. We support the proposed decisions on the stand-by arrangement and the structural adjustment facility.

Mr. Kabbaj made the following statement:

At the outset, I wish to support the proposed decision on the second review under the stand-by arrangement with Tanzania and the request for arrangements under the structural adjustment facility. I generally agree with the staff's appraisal.

The authorities continue to implement courageously their recovery and rehabilitation program. Although some slippages occurred in the area of agricultural marketing and pricing policies and in the elimination of payments arrears, a set of structural measures has already been introduced to further adjust the exchange and interest rates, to reduce price control, and to increase agricultural producer prices. Along with tight fiscal and monetary policies, these measures had a positive impact on the economy. Inflation was brought under control, and the targets for GDP growth and the current account deficit were met.

As pointed out in Mr. Abdallah's interesting statement, the authorities are committed to strengthening their efforts so as to correct economic and financial imbalances and achieve a sustainable rate of growth. In this regard, the policy framework paper, which covers the period 1987-90, would help the authorities design and implement the required corrective measures. Special emphasis would be put on the agricultural sector with more reliance on private initiatives in the marketing of food crops and improvement of producer prices. Perhaps the most important measure will be the reorganization of the National Milling Corporation, whose inefficiency created some difficulties in implementing the program. Among other principal structural adjustment measures, the Government will reduce the budget deficit and increase the allocation of foreign exchange on a priority basis to the most efficient enterprises in order to enhance industrial capacity utilization. A reform of the banking system to improve its efficiency is also contemplated; however,

delaying the preliminary discussion of this reform until June 1988 is questionable, given its importance and the time required to implement the necessary measures. Perhaps the staff could comment on this subject.

The medium-term prospects appear somewhat fragile, with sizable budget and current account deficits and a subsequent heavy dependence on external resources. While the debt service ratio is expected to decline from 55 percent to 34 percent between 1987 and 1991, this will occur only if future inflows can be received on concessional terms.

I note that the employment sector is not covered in the policy framework paper. While the freeze on employment in the civil service will continue and the investment program will focus only on restructuring and rehabilitating existing capacity, no specific measures have been designed on employment, especially the shortage of skilled manpower. Any comment from the staff would be helpful.

Mr. Rousset said that he joined previous speakers in supporting the completion of the review and the proposal for arrangements under the structural adjustment facility. Difficult prospects lay ahead for the authorities, and they needed to develop more specific measures quickly. Clearly, Tanzania would need to pursue its adjustment efforts with determination to meet the objectives set forth in the policy framework paper. In those endeavors, Tanzania deserved and needed Fund assistance both on technical and financial grounds. Therefore, a new stand-by arrangement, after the expiration of the present one in February 1988, would be fully warranted.

Mr. Mawakani noted that progress had already been made by the authorities in implementing the first year Economic Recovery Program. Much more was left to be done, particularly given the slippages in the credit area that had been noted in March and June 1987. However, the authorities had taken appropriate measures to correct that situation. The authorities should push the implementation of the Economic Recovery Program. He supported the request for the arrangements under the structural adjustment facility.

The staff representative from the African Department said that at first glance it might appear that little progress was being made on the budget deficit, but that view was not correct. For a number of years the size of the budget deficit had been obscured by the large subsidy to the Government resulting from the overvaluation of the exchange rate and low real interest rates on the public debt. The adjustment in the exchange rate and real interest rates in the previous 18 months had increased the nominal value of expenditure at a faster pace than the nominal value of revenue. That effect had offset the underlying improvement.

Indeed, it was important to consider the savings performance of the Government, the staff representative went on, although focusing on that performance was not always easy. Frequently, current expenditure was as useful or more useful than public investment, especially in a country like Tanzania where the need for maintenance was as large or greater than the need for new investment. It was also difficult to classify what was current expenditure and what was public investment. At any rate, there had been a major improvement in the underlying savings performance, which had been hidden by the increase in interest rates and in the exchange rate.

As for monetary policy, there was currently an increase in velocity, the staff representative remarked. For many years most prices in Tanzania had been controlled; only recently, as controls were removed, had the excess liquidity been reflected in higher prices. That process was expected to continue in 1988.

In 1986, the Paris Club had decided to reschedule Tanzania's debt for only the first 12 months of the 18-month stand-by arrangement, the staff representative from the African Department commented. However, it was the staff's understanding that the Paris Club would reschedule the debt for the remaining six months. The Tanzanian authorities had already requested that rescheduling. If there were no second stand-by arrangement, but only an arrangement under the structural adjustment facility, then the question would arise as to whether the Paris Club would reschedule on the basis of that program. New sources of financing were also possible, including the World Bank, which was considering a further increase in the size of its program.

The staff representative from the Exchange and Trade Relations Department said that the problem created by the periods of the stand-by arrangement and the structural adjustment arrangement not overlapping precisely was an administrative procedural problem, not one of substance. The Paris Club had agreed to consider rescheduling for the remaining period of the stand-by arrangement, which left a financing gap for some part of the period under the structural adjustment arrangement. The staff and the Paris Club secretariat could be in contact on how to overcome that problem.

The Chairman noted that there should be no interruptions in the momentum of an adjustment effort, especially when that effort needed strengthening.

The staff representative from the African Department commented that the target adopted earlier by the authorities on increasing producer prices by either 5 percent a year in real terms or setting them at a certain level of export prices would be somewhat difficult to implement. With the significant decline in world market prices, it might not be possible to have a further increase in real producer prices even given a reasonable exchange rate. The target of reaching 70 percent of the world market price depended to a large extent on the crop. Marketing costs of

30 percent might be quite high, for some crops, but quite low for other crops depending on the amount of processing required. However, that target existed, having been adopted two years earlier by the authorities.

The first goal was a realistic exchange rate. It was not possible to have realistic producer prices for export crops as long as the exchange rate was overvalued, because the marketing boards would have a large operating deficit. That was precisely what had happened in 1986 when, although producer prices might have been reasonable, the exchange rate had cut into the marketing board's profit margins, resulting in a large operating deficit. That deficit was subsequently covered by bank overdraft, which, in turn, affected monetary policy considerably. In fact, the bank overdraft to compensate for the marketing board's losses was somewhat larger than the deficit of the Central Government.

Therefore, the first requirement was to establish a realistic exchange rate, which was certainly the most important target in the program, the staff representative noted. In the previous four months, the real exchange rate had depreciated by about 12 percent--5.5 percent in October alone--which represented a definite acceleration in the speed of the adjustment.

For the export crops, the exchange rate was not the only problem, the staff representative from the African Department commented. The extremely high cost of marketing, which had been increasing over the previous two years, was a major systemic problem that was not easy to solve. Tanzania had reintroduced the system of cooperatives while at the same time it had kept the marketing boards, thereby increasing rather than decreasing the cost of marketing. Obviously, the system needed to be changed. In addition, a large part of the cost was due to transportation problems. However, it would take a number of years to improve transportation and require a tremendous amount of investment. Most roads would have to be completely rebuilt. Transportation costs would remain high for quite a number of years in Tanzania.

The staff representative from the World Bank noted that the World Bank staff had completed a study of the transport sector, which had been discussed with the authorities. The report was to constitute the basis for a meeting of donors to be convened by Tanzania on December 14 and 15. The intention was to reach a consensus at that meeting on the magnitude of the problems spelled out in the report and their priorities, which focused mostly on rehabilitation and maintenance. The goal was to obtain from the donor community an indication of the amount of funding that might be available to attack the transport problems, after which, the World Bank staff would work with the Government to implement the report's plan of action, including contributions by the donor community.

There was also a Bank staff mission in Tanzania at that moment preparing a public expenditure review, which would take into account the financial requirements for the transport sector laid out in the report, the World Bank representative said in closing.

Mr. Abdallah noted that the Board should not forget that the minimum wage in Tanzania was \$20 a month. It was difficult for the Government to give a higher wage increase at the top than at the bottom of the civil service when everyone was earning less than \$1 a day. Those were some of the tough realities to remember when considering Tanzania.

Tanzania's adjustment process was entering a delicate phase, Mr. Abdallah continued. Fortunately, the current problems were caused by success, for which the Fund and the World Bank should be congratulated. The situation was much better currently than it had been three years' earlier, and the authorities needed to be convinced that things could be even better in the future. Goods were available in the shops, but individuals needed to have the money to buy them. In Tanzania it was necessary to reach the masses, through the party structure that went right to the village, and did not stop with parliament.

There was urgent need to improve the transport system because many rural areas had stocks of many exportables that at present could not be moved to the port for shipment, Mr. Abdallah noted. Also, there were credit problems, because even a private buyer needed financing to move goods. Therefore, it was necessary to remember that Tanzania's success generated yet more problems. However, because the Tanzanian system was working so well, it was having a regional impact, which was a positive factor.

The Executive Board then took the following decisions:

Review Under Stand-By Arrangement

1. Tanzania has consulted with the Fund pursuant to paragraph 4(b) of the stand-by arrangement with Tanzania (EBS/86/183, Sup. 1, 8/29/86), as amended (EBS/86/183, Sup. 2), and paragraph 4 of the letter dated August 8, 1986 from the Minister of Finance, Economic Affairs and Planning, in order to review progress made under the stand-by arrangement and establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated September 28, 1987 from the Minister of Finance, Economic Affairs and Planning shall be attached to the stand-by arrangement for Tanzania, and the letters dated August 8, 1986, and April 27, 1987 attached to the stand-by arrangement shall be read as supplemented by the letter of September 28, 1987.

3. Accordingly, Tanzania will not make any purchases under this stand-by arrangement that would increase the Fund's holdings of Tanzania's currency in the credit tranches beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the ceiling on net domestic credit to the Government of the banking system as described in paragraph 15 of the letter dated September 28, 1987; or

(ii) the limit on the net domestic assets of the banking system described in paragraph 16 of the letter of September 28, 1987; or

(iii) the limit on total bank credit to the specified seven parastatals as described in paragraph 16 of the letter of September 28, 1987; or

(iv) the cumulative reduction in external payments arrears through cash payments, and the limit on accumulating new external payments arrears, as described in paragraph 22 of the letter of September 28, 1987; or

(v) the limit on new external borrowing on nonconcessional terms in the maturity ranges of 1 to 15 years, and of a maturity shorter than 1 year, excluding normal import trade credits, as described in paragraph 22 of the letter of September 28, 1987; or

(vi) the ceilings on the overall budget deficit, as described in paragraph 15 of the letter of September 28, 1987;

are not observed; or

(b) after February 14, 1988, until the review described in paragraph 24 of the letter of September 28, 1987 has been completed.

4. The Fund decides that the second review under paragraph 4(b) of the stand-by arrangement is completed and that Tanzania may resume the making of purchases under the arrangement.

Decision No. 8718-(87/151), adopted
October 30, 1987

Structural Adjustment Arrangement

1. The Government of Tanzania 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 Tanzania (EBD/87/250, 10/6/87), and approves the arrangements set forth in EBS/87/213, Supplement 1.

Decision No. 8719-(87/151), adopted
October 30, 1987

2. CHAD - STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff paper on Chad's request for an arrangement under the structural adjustment facility (EBS/87/209, 10/7/87; and Cor. 1, 10/23/87).

Mr. Mawakani made the following statement:

Three months ago, Executive Directors had the opportunity, at the conclusion of the Article IV consultation with Chad, to examine the policy framework paper covering the period 1987-90. On that occasion, they assessed in detail recent economic and financial developments in Chad as well as the medium-term prospects and made constructive recommendations on the required macroeconomic and structural adjustment measures that could facilitate the reconstruction of the economy while reducing the internal and external imbalances. My authorities would like to assure the Board of their commitment to intensify their adjustment efforts as described in the Memorandum of Economic and Financial Policies (EBS/87/209, Annex A). To support these efforts, they are requesting the first annual arrangement under the structural adjustment facility.

For today's discussions, I wish to concentrate on three areas--namely, cotton, fiscal, and the external sector.

The main targets for the real sector during the first year's program are the achievement of a 1.2 percent real GDP growth and the containment of the rate of inflation to 4 percent. The Chadian authorities are well aware of the implications for the achievement of these targets in terms of the required reform of COTONTCHAD, given the impact of this parastatal company on the overall economic activity and financial developments in the country. It should be recalled that the Government has defined a rehabilitation program for the cotton sector and designed a two-year emergency support program with assistance from the World Bank, the Fonds d'Aide et de Coopération, the Caisse Centrale de Coopération Economique, the Commission of the European Communities, and the Netherlands. In the context of this emergency support program, they are firmly implementing remedial measures called for in the first phase of the cotton rehabilitation program--July 1986-June 1988. These interim measures

should allow COTONTCHAD to withstand the abrupt and dramatic shortfalls in cotton export earnings that have taken place in the recent years.

To be sure, these measures have met with some success as evidenced by the substantial reduction in COTONTCHAD's production costs and the progress made in its costs recovery program. Moreover, beginning with the 1987-88 crop year, cotton producers are to pay the full cost of the inputs in order to further strengthen COTONTCHAD's financial position. In addition, pending the preparation of a comprehensive medium-term rehabilitation program of the cotton sector, a series of actions aimed at further reducing production costs and restoring the cotton sector's profitability are under consideration. My authorities are of the view that these measures, together with the expected improvement in world cotton prices, will strengthen COTONTCHAD's financial position.

The Chadian authorities are pursuing policies aimed at containing the fiscal deficit to a level which can be financed by external budgetary assistance. At the same time, they are strengthening public domestic resource mobilization. To this end, a number of measures are being implemented.

On the revenue side, the authorities are strengthening tax administration, with a view to reducing import tax exemptions and ensuring the payment of the poll tax, as well as improving tax collection. Given the urgent need to accelerate revenue receipts, a major reform of the tax system pertaining to the petroleum sector was launched in August 1987, as an interim measure, and the authorities are planning to introduce a new and permanent tax system with technical assistance from the World Bank. It is expected that all the elements of this new tax system will be in place by the end of 1987 and will contribute to the doubling of the tax revenue stemming from this sector.

On the expenditure side, additional efforts have been made to curb total budgetary outlays. Concerning current expenditures, a reduction of some 3 percent has been made from the originally budgeted level. Furthermore, the wage bill and military expenditures, which are now included in the budget to facilitate expenditure control, will be closely monitored. With regard to investment outlays, an investment budget has been prepared which should help to assess the recurrent costs of development projects and keep them under control.

So long as the cotton sector remains subdued, the external sector position will continue to be difficult. This underscores the need to diversify the productive base. In this respect, efforts are being made toward developing other agricultural activities, including livestock where there is a large potential

for production and exports. In addition, projects being financed by the International Development Association would help improve the economy's export prospects.

With regard to the external debt, the Chadian authorities are following a prudent debt policy as evidenced by the low debt ratio and the highly concessional nature of the debt. The authorities' willingness to settle their arrears before the end of this year is a demonstration of their keen interest in restoring the confidence of donors and creditors in the Chadian economy.

In sum, the economic and financial situation of Chad is difficult, and is expected to remain so over the medium term. Cognizant of this situation, the Chadian authorities have already adopted a package of measures to address the structural problems facing their country. However, given the need for the reconstruction of the country, the financial requirements are large and far exceed Chad's limited resources. The authorities hope that Fund support under the structural adjustment facility will elicit that of other donors to help them speed up the adjustment process and rebuild their war-damaged economy.

Mrs. Walker made the following statement:

In view of the difficult economic situation Chad faces, we welcome the authorities' commitment to begin a very critical and demanding adjustment process. Chad begins this effort from a weak economic base, and even with such a program, the economy will continue to face severe constraints. Thus, it is critical that the adjustment program be carried out to its fullest, because without this level of adjustment, the future will be even more difficult and recovery postponed.

It is unfortunate that the fiscal projections for 1987 were not able to be realized, although we recognize that the authorities did take steps, in light of that outcome, to increase revenue where possible and cut already low expenditure levels. Control of the budgetary process, including prompt merging of extrabudgetary expenditure into the budget, is critical if the budget is to be an effective instrument for financial control and planning. We urge the authorities to take all steps to ensure success in this area.

In light of the importance of the budgetary process as a policy tool in this adjustment program, it would have been more prudent to coincide the structural adjustment arrangements with the budget cycle. While we will be receiving an update on the fiscal benchmarks later this year, which is very helpful, and in fact necessary, placing the first year structural adjustment arrangement on the same cycle as the budget would have been a

more appropriate way to proceed with this particular program. We would appreciate staff comment on why the first year of the structural adjustment arrangement could not have been placed on a calendar year.

The formation of an investment budget for the first time is a very positive step toward fiscal responsibility, and we look forward to its contribution to efficient expenditure control. Instituting a realistic investment program involves timely consideration of the recurrent budgetary cost of Chad's foreign-financed development projects and thus this should be given immediate attention.

A reduction in the civil service will also be a tool for cutting current expenditure. We would have thought that a benchmark in this area might also have been appropriate. In addition, movement in the area of parapublic sector reform will also contribute to the adjustment process and a benchmark in this area would also have been useful for monitoring progress in this important area. A key component of the fiscal adjustment effort, however, will be implementation of a permanent petroleum taxation system by the end of 1987 at the latest, and we urge the authorities to move promptly in this direction. All efforts that can be made in improving tax administration and collection are needed.

While improvements have been made and are planned for the cotton sector, efforts will need to be focused on diversification of the economy in order to enhance future growth potential. In this regard, it is unfortunate that a key policy tool in this area, the exchange rate, is not able to be considered, particularly for a country facing such adverse economic conditions.

Provision of an adequate expansion of credit to the noncotton sector should be able to play an important role in fostering development of the private sector. Improvements in the banking system are urgently needed. In this respect we welcome the payments on COTONTCHAD arrears and would appreciate confirmation from the authorities that such payments will continue to be made so that the bank moratorium will be lifted as scheduled at end-1988.

Finally, we believe that this structural adjustment arrangement represents the beginning of a very difficult adjustment process for Chad. In our view, the program, if implemented, should provide Chad with a base from which even further adjustments must be made in order to bring about the development and growth desired.

Mr. Rousset made the following statement:

We fully support the proposed decision. My authorities have long considered an arrangement from the Fund as instrumental in providing Chad with the necessary guidelines for the reconstruction of its economy. Therefore, we are particularly pleased with the conclusion of this arrangement under the structural adjustment facility.

Chad is somewhat different from the cases usually discussed in the Board, needing in many respects, more of a reconstruction, than an adjustment, program. Indeed, Chad has neither an over-developed public investment program nor a huge wage bill. Therefore, the margin for adjustment is limited, as are the short-term possibilities for mobilizing domestic resources--two elements that have a direct impact on the content of the first-year structural adjustment arrangement and on the need for external assistance.

There are no spectacular recommendations in the program. Most merely advise that Chad take a prudent stance on the management of current expenditures, on public investment, and on monetary policies. The only measure that will have an immediate sizable impact on budgetary revenues is the reform of the petroleum tax system. This reform is expected to generate CFAF 6 billion annually--about one third of total revenue. The steady implementation of this reform is therefore essential, and we encourage the authorities to devote all their attention to monitoring it.

The policy framework paper rightly stresses the large volume of investments required to provide basic services to the population and infrastructure and to develop existing potential, especially in agriculture and livestock. These investments will have to be spread over time and financed through concessional external assistance. In this regard, we welcome the efforts made to present the first public investment budget in 10 years. We encourage the authorities to pursue the preparation of this investment program since its presentation will allow them to mobilize a greater number of donors for both project and non-project lending.

In view of these considerations, it is clear that the World Bank has a prominent part to play in the design and financing of Chad's adjustment program. In 1987, the Bank has already been active in a joint effort on the part of several donors to support the first phase of the rehabilitation of COTONTCHAD, the mixed enterprise in charge of the cotton sector. As a second phase of the program, this joint effort should aim for a settlement of COTONTCHAD's arrears to the banking system. We believe that this will be instrumental in the strengthening of the banking system and its ability to serve the Chadian economy.

Mr. Goos said that he agreed that Chad was more a case for reconstruction than adjustment. Therefore, the World Bank would need to play a prominent role in the process. As for the policy framework paper, it raised certain questions as to the appropriateness of the pace of the stabilization effort, especially in the fiscal and external area. Also, the time frame for the contemplated structural reform measures was unclear. Therefore, and considering further that the fiscal benchmarks had been formulated only in a preliminary manner, it was difficult to ascertain the prospects for the adjustment effort.

There had been no discernible progress of adjustment in the external current account, Mr. Goos continued. After an increase to 36 percent of GDP in 1987, the current account deficit was expected to remain at about that level throughout the period covered by the projections. Of course, the scope for adjustment might be limited in view of the resource base of the country. Nevertheless, stronger adjustment efforts aimed at improving domestic savings were called for, and were possible, even in such a poor country given the right incentives. Also, with improvements in efficiency of resource utilization, it should be possible over such a long projection period to see progress in the external accounts.

Mr. Jones made the following statement:

The characteristics of Chad's economy and the complexity of its problems make it a prime candidate for an arrangement under the structural adjustment facility. At the outset, therefore, I can register my support for the proposed decision.

The financial needs of Chad are enormous, and this structural adjustment arrangement cannot substitute for donor assistance and concessional financing from other multilateral institutions. But financing is not all that is required for economic recovery and long-term development. A country must also have a well-conceived adjustment program. By working with both the Fund and the Bank, the authorities have attempted to identify the constraints to their economy and to focus more closely on what they can do with the help of the international donor community to grapple with the difficulties that face them.

To be sure, expectations about what the authorities can achieve, at least over the medium term, must be tempered by recognition of the country's limited capacity to adjust, and this program cannot but be a first step along a long and arduous road. We must keep in mind that Chad's economy is vulnerable to poor weather; its high degree of dependence on cotton leaves it virtually at the mercy of developments in the international market for this commodity; its infrastructure is in a state of disrepair; and the many years of internal conflict have drained the financial resources of the Government and seriously shaken the social fabric.

The staff has appropriately identified the issue when it says in the appraisal that "the country faces the urgent need to reconstruct its economy and to restart the development process." This being the case, one would have to look to a longer planning horizon for significant results to be accomplished, and the World Bank must be expected to take the lead among international institutions in helping to formulate and finance appropriate development programs and projects. Also, much help will be needed from the donor countries in the years ahead, without which the development process could not even begin. So far, the international community and, in particular, France have been extremely helpful and deserve our commendation.

The authorities seem to have developed the political will to proceed with prudent economic policies. They are making an effort to diversify their economy and to strengthen the financial position of the public sector, including public enterprises. However, with military expenditure taking up a large share of recurrent expenditure--35 percent in 1986--the authorities face the dilemma of cutting outlays on goods and services at the cost of impairing the efficiency of public administration. The low level of wages, which is about 60 percent of the salary scale established as long ago as 20 years, is also bound to affect morale in the civil service.

The medium-term outlook for an average annual increase in real GDP of 2 percent between 1988-92 is not encouraging, even disturbing, because it means that Chad faces a further prolonged decline in its per capita income, which is already one of the lowest in the world. Moreover, even the rate of growth that is projected hinges on a number of assumptions beyond the control of the authorities, such as good weather, large increases in capital inflows, and sustained increases in cotton export prices. Unquestionably, Chad's situation will require perseverance on the part of the authorities and flexibility and imagination on the part of the international community.

Mr. Puro made the following statement:

In spite of the progress made in Chad's economic development in recent years, the country still faces problems of serious internal and external imbalances. The authorities' intention to continue their reconstruction and adjustment policies in the context of a medium-term program is highly necessary and welcome. The requested structural adjustment arrangement seems to provide appropriate support for these efforts.

Despite attempts to diversify the economy, Chad will be highly dependent on cotton exports in the long term. Therefore, it is vital that the cotton sector is rehabilitated and put on a sound financial footing.

As Chad is a member of the Central African Monetary Union, exchange rate measures are not possible; thus, cotton sector adjustment has to be undertaken mainly through prices and costs, which is more difficult than exchange rate action. Nevertheless, encouraging results have already been achieved in reducing production costs and improving COTONTCHAD's financial and operating position. It is important that all difficult adjustment measures, such as abolishing subsidies and the practice of setting producer prices, are fully implemented, as described in the policy framework paper.

Government finances are strikingly weak, and the country is almost completely dependent on external assistance for its investment expenditures. In the long term, the authorities must be prepared to cope with dwindling external budgetary assistance. Nevertheless, in the present situation a containment of the budget deficit by not making further recourse to domestic bank borrowing is a reasonable program target. To reach this objective, emphasis must be placed on improving tax collection by promptly implementing the plans to strengthen the tax administration and by making the petroleum taxation system permanent. It is to be hoped that the major thrust attached to the new expenditure control system is warranted and that outlays can be curtailed. In the efforts to cut spending, military expenditure and the wage bill are central.

In the financial area, a cautious credit policy is necessary. However, because of its narrow framework, the noncotton sector should be allotted sufficient access to credit in order to proceed with the diversification of the country's production base. In order to normalize the financial situation, it is also essential that both domestic and external arrears be eliminated.

There is no doubt that Chad has considerable development potential, but the road to full utilization of this potential is difficult. In the present situation, the international financial community and the donor countries must provide Chad with necessary external financing to facilitate the country's adjustment efforts. An important link in this process is Chad's request for an arrangement under the structural adjustment facility, which I warmly support.

Mr. Kabbaj said that the arrangement with Chad under the structural adjustment facility was welcome. In fact, given Chad's situation, it was surprising that the country had been required to undergo such a lengthy process as submitting the policy framework paper in order to obtain an arrangement. The process ran counter to the flexibility with which the structural adjustment facility should be operated. In the forthcoming second paper on the enhancement of the structural adjustment facility,

the staff should address the issue of simplifying structural adjustment facility procedures in cases where there was a lack of economic and statistical data and where special conditions hampered normal procedures.

Mr. Al-Assaf made the following statement:

First, let me say that I support the proposed decision and welcome the Chadian authorities' decision to address their problems within the medium-term framework supported by the structural adjustment arrangement.

As we know, the economy of Chad depends on the cotton sector, especially for budgetary and foreign exchange receipts. Therefore, I welcome the COTONTCHAD rehabilitation program. The restructuring of this company, including cutting costs and improving its debt position, is essential to its viability. Further, in view of the importance of this sector to the economy, its restructuring would be instrumental in achieving the growth target for the country as a whole.

Chad's revenue base needs to be widened through improvement of the tax system and tax administration. The growth of current outlays should be kept under control. Strict discipline in the wage bill needs to be continued. As far as developments on the investment front are concerned, I welcome the adoption of the investment budget for 1987 and the associated administrative policies, which will help in the appropriate selection of projects and their future operating financial requirements. The authorities should vigorously pursue the consolidation of the Government's financial operations; extra budgetary expenditure consolidation within the main budget is essential in that respect.

I encourage the authorities to keep the expansion of domestic credit under control. Under normal circumstances credit expansion of 15 percent is on the high side, and could have inflationary implications, but considering Chad's excess capacity and the need to expand the noncotton sector, I agree with the staff assessment.

Although Chad is blessed with relatively low debt with high concessionality, it still has some difficulties in servicing its debt. I therefore urge the authorities to continue their practice of obtaining foreign aid in the form of grants and highly concessional loans only, and to improve their debt administration to avoid detriment to the generation of new assistance. It is also important to select the appropriate investment in the use of this aid.

To conclude, the authorities realize the difficult economic and financial position of the country and the need to address their problems within a medium-term framework. Therefore, it is important for them to persevere with their adjustment efforts.

The staff representative from the African Department noted that in the Board's discussion of the Article IV consultation with Chad on June 19, Directors had expressed the hope that negotiations would begin in the near future on a structural adjustment arrangement for Chad. As a result, the authorities had requested a Fund staff mission to travel to N'Djamena as soon as possible to begin those discussions. A mission had been sent in early July. Therefore, it became difficult to avoid a program that covered two fiscal years.

A census of the civil service was currently being completed, the staff representative continued. Once completed, the results would be used by the authorities to make decisions regarding staffing levels in individual ministries. Therefore, it would be possible to establish a benchmark for the size of the civil service in the second annual arrangement, but not in the first year's arrangement. Also, studies of the operations of the public enterprises were currently under way, and once completed, it would be possible to establish meaningful benchmarks in that area.

Adjustment in the external sector was necessarily quite slow, the staff representative from the African Department commented; in fact, scope for further adjustment was quite limited. Moreover, the prospects for expanding export receipts in the short run were circumscribed by the situation in the cotton sector, which was not expected to become fully profitable before the end of the decade. Under those circumstances, it was not realistic to expect a major strengthening of the current account before then.

The staff representative from the Exchange and Trade Relations Department noted that there was no written rule that programs set out in policy framework papers should fall within calendar or fiscal years. In fact, there might be advantages in setting dates for structural adjustment programs that spanned two fiscal years, because that way, the staff could help guide policy formulation at the time of setting the budget. Unfortunately, there would always be midcourse corrections in policy programs, as developments would cause the authorities to reconsider their own targets. Therefore, there was nothing wrong with the program overlapping two fiscal years, particularly if the dialogue that the staff had with the authorities was timed so that the Article IV discussions could be held at the same time of the budget formulation.

Mrs. Walker noted that, although she was in agreement with the staff, the Board was being asked to approve a program that had started in July 1987 for a fiscal year that would begin two months from the date of approval of the arrangement, on January 1, 1988. It would appear beneficial to coincide the period of the program with that of the fiscal year to the extent possible.

Mr. Mawakani said that the authorities had had the opportunity to examine all aspects of the structural adjustment program in N'Djanema and

at the annual meetings. The discussion on that program had started in 1985, so it had not been difficult for the authorities to reach an agreement with the Fund.

The authorities were implementing a rehabilitation program for the cotton sector that had been started in June 1986, Mr. Mawakani noted. Indeed, the cotton sector was the most important source of budget revenue and external receipts.

The Executive Board then took the following decision:

1. The Government of Chad has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.
2. The Fund approves the arrangements set forth in EBS/87/209, Supplement 1.

Decision No. 8720-(87/151), adopted
October 30, 1987

3. EXECUTIVE DIRECTOR

The Executive Directors bade farewell to Mr. Foot at the conclusion of his service as Alternate Executive Director.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/150 (10/28/87) and EBM/87/151 (10/30/87).

4. ADVISORS TO EXECUTIVE DIRECTORS - REMUNERATION

The Executive Board approves, with one objection, the recommendation to increase the remuneration of Advisors to Executive Directors set forth in EBAP/87/229 (10/23/87) and Supplement 1 (10/29/87).

Adopted October 28, 1987

5. KIRIBATI - TECHNICAL ASSISTANCE

In response to a request from the Kiribati authorities for technical assistance in preparing a study on the establishment of a central monetary institution, the Executive Board approves the proposal set forth in EBD/87/275 (10/26/87).

Adopted October 29, 1987

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 87/53 through 87/55 are approved. (EBD/87/271, 10/22/87).

Adopted October 28, 1987

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/232 (10/27/87) and EBAP/87/233 (10/28/87) and by an Advisor to Executive Director as set forth in EBAP/87/233 (10/28/87) is approved.

8. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/87/235 (10/29/87) is approved.

APPROVED: June 6, 1988

J. W. Lang, Jr.
Acting Secretary

