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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/77

3:00 p.m., May 6, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	M. K. Bush
	E. L. Walker, Temporary
	P. Péterfalvy, Temporary
M. Finaish	
H. Fujino	
	B. Goos
	Song G., Temporary
	Z. b. Ismail, Temporary
	J. Hospedales, Temporary
	M. Foot
	H. Fugmann
	L. Leonard
	A. Abdallah
	M. A. Weitz, Temporary
Y. A. Nimatallah	
	J. E. Rodríguez, Temporary
H. Ploix	
	J. de Beaufort Wijnholds
	A. V. Romuáldez
	A. A. Agah, Temporary
	A. S. Jayawardena
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: A. D. Ouattara, Director; G. M. Bartoli, E. A. Calamitsis, C. V. Callender, C. Enweze, U. R. Gunjal, G. Kalinga, J. K. M. Kinyua, E. K. Martey. Exchange and Trade Relations Department: E. H. Brau, A. Chopra. External Relations Department: H. O. Hartmann. Legal Department: H. Elizalde, A. O. Liuksila. Research Department: O. E. G. Johnson. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet, J. E. Blalock, J. C. Corr, D. V. Pritchett. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, W.-R. Bengs, M. B. Chatah, S. M. Hassan, H.-S. Lee, I. Puro. Assistants to Executive Directors: M. Arif, R. Fox, S. Geadah, V. Govindarajan, L. Hubloue, J. M. Jones, H. Kobayashi, R. Msadek, J. A. K. Munthali, J. K. Orleans-Lindsay, V. Rousset, A. J. Tregilgas, Wang X.

1. SIERRA LEONE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors considered a staff paper on the further review of Decision No. 8014-(85/101) G/TR on a complaint under Rule K-1 with respect to Sierra Leone's overdue financial obligations in the General Department and the notice of Sierra Leone's failure to settle obligations to the Trust Fund (EBS/86/99, 4/30/86).

The staff representative from the Treasurer's Department noted that the Fund had received no payments from Sierra Leone since the distribution of EBS/86/99.

Mr. Abdallah said that during the previous several days he had been in close contact with the authorities concerning their overdue financial obligations to the Fund. In their communications to him the authorities had clearly shown that they appreciated the gravity of the present situation concerning Sierra Leone's overdue obligations. Accordingly, the authorities had issued instructions to their bankers to remit a total of $4.8 million to the Fund. That amount was expected to be realized from the sale of gold and diamonds that had recently been purchased by the Government and were awaiting disposal in the Antwerp market. Unfortunately the transaction had been delayed because the Antwerp market had been closed for a while. The market had reopened on May 5, 1986, and the authorities expected the transaction to be completed within the coming ten days and to transmit the receipts from the sale to the Fund immediately thereafter.

The authorities' intention to eliminate all their arrears to the Fund had been mentioned in the staff paper, Mr. Abdallah commented. Because of the size of the arrears it was not possible for the authorities to eliminate all of them by using Sierre Leone's own resources; the country's supply of foreign exchange had been virtually exhausted. The authorities believed that a bridging loan could be arranged once an adjustment program had been introduced.

However, the full implementation of the program that had already been agreed with the staff had been delayed because of unforeseen developments, Mr. Abdallah said. Those developments had caused the authorities to advance the next Parliamentary elections by one year in order to mobilize public support for their adjustment efforts. The election date had recently been slightly adjusted owing to administrative complications. The general elections were scheduled to be held on May 30, 1986, and a new cabinet would be appointed shortly thereafter. By the second week of June 1986, the next government should be in office and should be fully poised to implement the strong and comprehensive adjustment program that had been agreed with the Fund. A timetable setting out the sequence of events following the elections as foreseen by the present authorities had been presented to the staff by the Minister of Finance during his visit to Washington in April 1986. Under that timetable, a staff mission would visit Freetown within two weeks of the assumption of office by the new Cabinet.

Executive Directors should give the authorities the extension of ten weeks that had been proposed as an alternative to an immediate declaration of ineligibility, Mr. Abdallah considered. The extension would not be seen by the authorities as a grace period, because firm arrangements had been made for the authorities to make a sizable payment by the middle of May 1986. The authorities were serious about their commitment to the Fund and realized that time was not on their side. That commitment and realization were evident in recent communications to him from the Minister of Finance and the State House which stated in part that "no further extension will be requested after this one, as the new Government would have been formed to implement the package of measures." The authorities should be given the benefit of the doubt.

Mr. Mawakani said that it was regrettable that Sierra Leone had made no further payments to the Fund since the previous discussion on the country's arrears, and that additional arrears had accumulated. Mr. Abdallah's opening statement indicated the seriousness with which the authorities viewed the present critical situation. He welcomed the timetable that they were following for establishing a new political administration that was expected to implement the comprehensive adjustment program that had already been agreed with the staff. Given the assurances that Mr. Abdallah had provided and the information in the staff paper, he favored the second option of paragraph 4 of the draft decision, under which the declaration of ineligibility would be postponed until June 16, 1986. The authorities should use the coming period to secure the necessary bridging loans that would enable them to eliminate their arrears to the Fund.

Mr. Nimatallah remarked that the authorities faced a political problem, as they needed additional time in which to conduct elections. He attached considerable importance to the fact that the authorities had remained in contact with the Fund in the period since the arrears had begun to accumulate. The staff had visited the authorities, who had made a clear commitment to implement certain measures. The authorities had unfortunately been unable to implement the measures because of the factors that Mr. Abdallah had described. He agreed that the authorities needed additional time to solve the particular problems facing them, and that it would not be helpful for the Executive Board to adopt a declaration of ineligibility at the present meeting. The proposed decision--with the second version of paragraph 4--was acceptable.

Mr. Jayawardena observed that Sierra Leone had faced progressively severe economic problems following the massive deterioration in the terms of trade since 1980 and the interruption of the Fund-supported adjustment program for 1984/85. During the 1985 Article IV consultation with Sierra Leone, Executive Directors had agreed that the only way in which to avoid unduly harsh adjustment was to implement corrective measures that the Fund had suggested. Since then, Sierra Leone had elected a new President--at the end of January 1986--and his administration apparently wished to introduce the needed reforms. The President required the support of Parliament for the adjustment efforts, and elections had been scheduled for May 30, 1986. Mr. Abdallah had asked the Executive Board to agree to an additional ten weeks in which the President and the new Parliament could adopt the necessary comprehensive reforms. Such a request, in a long-standing democracy, was understandable. Moreover, Mr. Abdallah had noted that the authorities had stated that no further extension would be requested after the present one--as the new Government would have been formed to implement the measures--and that the authorities had given clear instructions that the Fund was to be paid $4.8 million in the immediate future.

He hoped that the authorities understood that the major exchange rate adjustment of early 1985 had been offset by the lack of appropriate supportive policies, and that permitting the development of a widespread parallel market was not an effective or humane way of adjustment, Mr. Jayawardena said. The medium-term balance of payments outlook indicated that financing gaps were likely to remain through 1989. In the absence of corrective policies, the payments situation would continue to be difficult. With adjustment and reasonable financing, the financing gap could be bridged and the debt service burden could be reduced to a manageable level. Given the extensive cross-border trade with neighboring countries, the authorities in Sierra Leone had no alternative to comprehensive adjustment. Accordingly, the authorities' commitment to adopt corrective measures was welcome, and the authorities should persevere in their efforts.

Sierra Leone was a small country with a small population, and was one of the poorest countries in the world with a per capita income of SDR 204, Mr. Jayawardena noted. Such countries were very vulnerable and had a limited capacity to introduce strong adjustment measures. Sierra Leone needed a comprehensive debt rescheduling and adequate external assistance to support its adjustment process. He would strongly support the provision of Fund assistance to Sierra Leone after the arrears to the Fund had been eliminated. The proposed decision, with the second version of paragraph 4, should be approved.

Mr. Agah said that Mr. Abdallah's opening statement and the staff paper indicated that the authorities were willing to eliminate Sierra Leone's overdue financial obligations to the Fund. The authorities were making a serious effort to make a sizable payment by the middle of May 1986. They had made a public commitment to implement the proposed comprehensive adjustment measures in order to reverse the unfavorable economic and financial trends in Sierra Leone.

Given the factors that the staff had mentioned on page 3 and page 5, which had been confirmed in Mr. Abdallah's opening statement, an immediate declaration of ineligibility would unnecessarily complicate an already difficult situation for the new Government, Mr. Agah considered. In the circumstances, he doubted whether the staff could give any assurances that earlier implementation of the measures would have helped Sierra Leone to meet its obligations to the Fund. After all, the new authorities had been in office a relatively short time. The authorities had a cooperative attitude toward the adjustment measures that had been agreed with the Fund and they deserved the Executive Board's understanding, particularly in the face of the policy actions that would be required soon after the forthcoming parliamentary elections. Mr. Abdallah's request to delay the declaration of ineligibility for ten weeks was acceptable. An immediate declaration of ineligibility would not be helpful for the Fund or Sierra Leone.

Mr. Fugmann remarked that recent experience suggested that the Executive Board often gave the benefit of the doubt to members with overdue financial obligations. Sierra Leone was a difficult case because there was little in the staff paper on which to build a case that Sierra Leone would benefit from a decision by the Executive Board to delay a declaration of ineligibility. However, Mr. Abdallah's opening statement contained some additional information. Furthermore, in previous cases, the scheduling of elections and the serious political disturbances had constituted a reason for the Fund to grant a further extension of the period. He saw no reason why the same approach could not be taken in the case of Sierra Leone.

The sequence of events that was envisaged by the authorities was a cause for some concern, Mr. Fugmann continued. The staff had noted on page 3 that the implementation of a program could facilitate the efforts to obtain bridging finance that would be used to eliminate Sierra Leone's overdue obligations to the Fund. However, according to established procedures, the Fund could not approve a program until the arrears had been eliminated. In addition, he wondered whether the proposed decision should not reflect the authorities' commitment not to request any further extension of the period in which Sierra Leone must repay the Fund in order to avoid a declaration of ineligibility. Without setting that as a condition, it would be helpful support to grant a further ten weeks in which to repay the Fund, as the ten-week extension was long in comparison with previous similar cases. With those reservations he could--somewhat reluctantly--go along with the second option of paragraph 4 in the proposed decision.

Mr. Hospedales remarked that the financial situation in Sierra Leone continued to be serious and difficult. The country was in the process of building a national consensus in support of a comprehensive adjustment program; the consensus was a key precondition for the successful implementation of such a program. Mr. Abdallah had reiterated the authorities' firm commitment to become current with the Fund. That commitment was reflected in the proposed payment to the Fund of $4.8 million.

The coming elections would be the first step in the effort to forge the national consensus in favor of comprehensive adjustment, Mr. Hospedales noted. A new cabinet was to be chosen, and the budget provided for the implementation of the needed adjustment measures. The request for an additional ten weeks in which to establish an appropriate framework for program formulation and implementation and to make needed financial arrangements was reasonable. Sierra Leone had continued to maintain its close cooperation with the staff, and he hoped that bilateral and multilateral concessional assistance, including Fund support, would be forthcoming. The proposed decision, with the second version of paragraph 4, was acceptable.

Mr. Leonard said that the present discussion was the fourth review of Sierra Leone's overdue obligations to the Fund since the arrears to the Trust Fund had appeared on January 25, 1985 and to the General Department on February 6, 1985. Since then, despite a number of occasional payments, the amount of overdue obligations had risen from SDR 4 million to SDR 16.7 million. Accordingly, Sierra Leone's intention to make a further payment to the Fund within the coming ten days was welcome. He sympathized with the authorities, who faced the difficulties that Mr. Abdallah had described in his opening statement. However, he was unable to accept Mr. Abdallah's proposal.

A case could be made for permitting Sierra Leone some additional time before a declaration of ineligibility was made, Mr. Leonard continued. The authorities had tried in difficult circumstances to make occasional payments and had expressed their commitment to meet all their obligations to the Fund, and it was possible that, with the recent change in government, the policy adjustments needed to restore external balance would be made. However, the authorities had already been given considerable time to make full payment to the Fund and had failed to implement corrective actions that had been agreed with the Fund in the past. In addition, it was not clear to him that the required degree of adjustment could be initiated and that arrangements for payment to the Fund could be made by July 16, 1986. Hence, a departure by the Executive Board from the procedures that had been adopted for similar cases would blur those procedures to the point at which their force and credibility would be dangerously undermined. The Executive Board should adopt the proposed decision with the first version of paragraph 4. It should be expected that the authorities and the Fund would continue to work together, so that adjustments of economic policy would be made and the provision of financial resources could be arranged so that Sierra Leone would be able quickly to normalize its relations with the Fund.

Mr. Weitz said that, in the light of the promised payment to the Fund, the assurance that Mr. Abdallah had given regarding the implementation of economic measures in the near future, and Mr. Abdallah's explanation of the political situation, the proposed decision with the second version of paragraph 4 should be approved.

Mr. Song stated that in light of the useful information that Mr. Abdallah had provided he accepted Mr. Abdallah's proposal to give the authorities ten additional weeks in which to make progress in settling their overdue financial obligations to the Fund.

Ms. Bush said that she had noted Mr. Abdallah's positive statement concerning the authorities' intention to implement needed adjustment measures. She wondered whether the staff felt that its negotiations with the authorities on the needed measures had gone sufficiently far to enable the authorities to adopt appropriate measures after the coming elections. A further comment on the potential bridging finance would also be helpful.

The staff representative from the African Department remarked that, on the basis of the information that had been given to the staff by the Resident Representative in Sierra Leone, the staff had no reason to believe that the authorities at the highest levels had backed off from the commitments that they had made during the discussion between the staff mission and the authorities in February 1986. At the same time, given the difficulties that had been mentioned by Mr. Abdallah and in the present and previous staff papers with respect to rice, fuel, and other factors, and given the opposition to some adjustment measures by interested parties, it seemed fair to conclude that, despite the commitment to adjustment at the highest level of government, the staff could not provide a full guarantee that the measures would be implemented immediately following the coming elections. The Finance Minister had met with the staff and management in April 1986 and had reaffirmed the authorities' commitment to implement the measures that had been agreed with the staff. The main difficulty at the present stage was the coming elections. It was conceivable that the highest political authorities could change their minds about some elements of the adjustment package. At present, there was no indication that that would happen.

The authorities had already indicated that they were interested in pursuing the possibility of bridging finance with potential creditors, the staff representative from the African Department said. There were two potential difficulties in arranging such financing. The first was the size of the possible arrears to the Fund at the time that the bridging finance would be sought. The staff had stressed to the authorities that it would be crucial for them to mobilize some of their own resources in addition to possible bridging finance in order to be able to eliminate Sierra Leone's arrears to the Fund. A second possible difficulty in arranging bridging finance was that, because of the existing financial problems in Sierra Leone, a potential source of bridging finance had indicated that it would require the authorities to meet some of Sierra Leone's outstanding obligations to that source before considering a request for bridging finance. That source had indicated that, if satisfactory arrangements could be made, it would not be adverse to providing the needed bridging finance.

Mr. Abdallah stated that the authorities' commitment to implement policies and repay the Fund was a firm one. The general public in Sierra Leone had accepted that belt-tightening was required. The President had toured the country informing the public about the difficult elements of the required adjustment policy package, including the need for remunerative prices and the associated need to abolish subsidies. The Government had in effect already implemented one aspect of the adjustment package by employing gold and diamonds at the parallel market rate in its recent purchase.

Ms. Bush said that the case of Sierra Leone was a difficult one. As Mr. Fugmann had noted, there was little or no information in the staff paper that would justify a course of action other than an immediate declaration of ineligibility. However, Mr. Abdallah had made a strong and positive statement about the authorities' intentions to implement comprehensive adjustment measures as part of a program supported by the Fund and to arrange bridging finance. In addition, the timing of the national elections appeared to be of crucial importance, and the authorities' commitment not to request any further extensions was comforting. On balance, the Executive Board should give the authorities the benefit of the doubt. She could go along with a consensus in favor of approving the draft decision, including the second version of paragraph 4.

Mr. Finaish stated that, in the light of Mr. Abdallah's positive and helpful statement, he supported the proposed decision, including the second version of paragraph 4. An immediate declaration of ineligibility would not be helpful to either the Fund or Sierra Leone.

Mr. Rodríguez considered that the proposed decision, including the second version of paragraph 4, was acceptable.

Mr. Zecchini said that Mr. Abdallah's statement about the authorities' willingness to make a partial payment in the near future was encouraging. At the same time, the lack of adequate economic and financial measures to deal with the serious problems facing Sierra Leone was disappointing. On the basis of the information in the staff paper, an immediate declaration of ineligibility seemed to be appropriate. However, Mr. Abdallah had noted the difficulties--including noneconomic ones--facing Sierra Leone. Those difficulties apparently could be eased in the near future. In addition, Mr. Abdallah had stressed that parliamentary elections were to be held in the near future, and that the long-awaited and much needed adjustment measures could be implemented soon after the elections. In the light of the information that Mr. Abdallah had provided, he could reluctantly accept the request for a ten-week delay in the declaration of ineligibility. However, it should be understood that the coming ten weeks should be used by the authorities to find an appropriate solution to the economic and financial problems facing Sierra Leone; the authorities should introduce adequate measures and should seek the needed bridging finance.

Mrs. Ploix said that, prior to Mr. Abdallah's opening statement, she had felt that it was regrettable that, since the previous discussion on Sierra Leone, the authorities had failed to give any positive or concrete sign concerning their readiness to settle their obligations to the Fund or to implement the needed economic policies. That failure had appeared particularly regrettable because more than 13 months had passed since the making of the initital complaint concerning Sierra Leone's overdue obligations. However, Mr. Abdallah's opening statement had been positive. Two arguments could be made in favor of granting Mr. Abdallah's request for an additional extension. First, a comparison between Sierra Leone and previous cases showed that, if Sierra Leone were declared ineligible at the present meeting, it would have been given the shortest period of any country between the first complaint and the declaration of ineligibility. Second, while specific economic measures should admittedly have been implemented some time previously, the tentative political situation pending the outcome of the coming parliamentary elections had not lent itself to a firm commitment by the Government to implement measures forthwith. In the circumstances, she could accept the proposed decision, with the second version of paragraph 4. However, it should be clearly understood that the extension would be meaningless unless the authorities took the opportunity of the newly defined political context to implement quickly the measures that had been agreed with the staff.

Mr. Foot considered that the case of Sierra Leone was a difficult one and was similar to that of Liberia. The arrears of both countries had been reported to the Executive Board on nearly the same date. Liberia faced a number of internal problems but had been declared in January 1986 ineligible to use the Fund's resources. The present discussion was the fourth review of Sierra Leone's overdue obligations, and if an argument could be made in favor of an extension for Sierra Leone it must be based on the partial repayments that the country had made. It should be clearly understood that, if Sierra Leone were unable to repay the Fund by July 16, 1986, the authorities would not request another extension. He was willing to go along with the consensus in favor of granting the requested extension until July 16, 1986. The addition to the draft decision that had been proposed by Mr. Fugmann was unnecessary. The points that Executive Directors had made during the discussion would be conveyed to the authorities in the Managing Director's communication to them following the discussion. He reluctantly accepted the proposed decision, with the second version of paragraph 4.

Mr. Goos said that he had originally intended to support the first version of paragraph 4 of the draft decision. Since the issuance of the Managing Director's complaint the Sierra Leonean authorities had had more than a year to introduce corrective measures and to eliminate the country's overdue financial obligations to the Fund. In that context, Sierra Leone clearly belonged to the category of members that had continued to fail to introduce adjustment measures despite repeated calls to do so by the Executive Board; in such cases, the Executive Board had made a declaration of ineligibility on the occasion of the third or fourth review. Accordingly, the adoption of the second version of paragraph 4 of the proposed decision could be seen as being inconsistent with the principle of equal treatment of members and could be taken as a weakening of the procedures for dealing with cases of overdue obligations. However, Mr. Abdallah had clearly explained that the authorities faced a serious political problem, and that they should be given the benefit of the doubt. Mr. Abdallah had given firm assurance that Sierra Leone would use the additional ten weeks to eliminate its arrears to the Fund.

Mr. Wijnholds recalled that the decision on Sierra Leone's overdue financial obligations adopted on March 12, 1986 (Executive Board Decision No. 8824-(86/45)) said that it was expected that a decision to declare Sierra Leone ineligible to use the Fund's resources would be taken with effect on the date of the next review in the absence of full settlement of the country's arrears to the Fund. He wondered whether the Executive Board had typically followed up such an expectation with a declaration of ineligibility.

The staff representative from the Treasurer's Department responded that the Executive Board had shown considerable flexibility with respect to the specific date on which expectation of a declaration of ineligibility was converted to an actual declaration of ineligibility. In a number of cases the Executive Board had decided that a declaration of ineligibility would not become effective until a date later than that reflected in the expectation contained in the preceding decision. In one case--Guyana--the expectation had been fulfilled on the date that had been originally set by the Executive Board, and the declaration of ineligibility had come into effect on that date.

Mr. Finaish remarked that each case of overdue financial obligations to the Fund had its own particular features. As Mr. Fujino had recently stressed, the objective of the handling of such cases was to ensure that the Fund would be repaid. The effectiveness of a declaration of ineligibility would be lost if declarations were made routinely in each case. The Executive Board had to be firm and to treat members uniformly, but it also had to use its best judgment in dealing with each case and to bear in mind the overall aim of enabling the Fund to be repaid.

The staff representative from the African Department said that on page 3 the staff had noted that the authorities wished to formulate an appropriate adjustment program, with the staff's assistance, as the implementation of such a program would facilitate the authorities' efforts to obtain bridging finance with which to become current with the Fund. As Mr. Fugmann had noted, the staff would not negotiate a program until the overdue financial obligations to the Fund were eliminated. The staff had discussed with the authorities the package of measures that they must implement in the stage prior to the formulation and implementation of a Fund-supported program.

Mr. Leonard considered that similar cases of overdue financial obligations should be treated in the same way. Sierra Leone was similar to cases that had been treated in a particular way in the past. He was worried that the Executive Board appeared to be moving in the direction of creating a new category of cases of overdue financial obligations that would be out of line with the established procedures for dealing with arrears to the Fund. Creating such a category would open the way for further shading of the existing procedures, thereby making it difficult for the Executive Board to act in a consistent manner in the future.

The Executive Board then took the following decision:

1. The Fund has reviewed further Decision No. 8014-(85/101) G/TR, adopted June 28, 1985, in light of the facts described in

EBS/86/99 (4/30/86), pertaining to Sierra Leone's overdue financial obligations to the Fund and to the Fund as Trustee of the Trust Fund.

2. The Fund regrets the continuing nonobservance by Sierra Leone of its financial obligations to the Fund in the General Resources Account and notes that further substantial obligations will become due in the near future. The Fund again urges the Sierra Leonean authorities to make full and prompt settlement of the overdue financial obligations to the Fund.

3. The Fund notes with concern the delays in implementing the adjustment measures announced early this year, reiterates the importance for Sierra Leone of implementing these measures urgently, and again calls upon Sierra Leone to adopt a strong and comprehensive program that would result in necessary economic adjustment.

4. Unless by July 16, 1986 Sierra Leone is current in its financial obligations to the Fund in the General Resources Account, with effect on that date Sierra Leone will be ineligible pursuant to Article XXVI, Section 2(a) to use the general resources of the Fund.

Decision No. 8277-(86/77), G/TR adopted
May 6, 1986

2. BOTSWANA - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Botswana (SM/86/65, 3/24/86). They also had before them a staff report on recent economic developments in Botswana (SM/86/79, 4/21/86; and Cor. 1, 4/29/86).

Mr. Abdallah made the following statement:

The economy of Botswana continued to make remarkable progress in 1985. The notable achievements are a high rate of growth of real GDP, record surpluses in the budget and the balance of payments, and a further increase in official reserves. These developments reflect the acceleration in output in the mining sector, whose share of GDP has nearly tripled since the mid-1970s, and the prudent policies of the Government, which have provided an environment conducive to the growth of private entrepreneurship.

The expectation is that 1986 will also be a good year for the economy, although the rate of growth of real GDP is projected to be much lower than 1985. The slowdown in the rate of growth is due mainly to the leveling off in the production of diamonds and the adverse effect of the drought on the production of beef.

Nevertheless, the 6 percent rate of increase in real output projected for 1986 is still higher than that of many other developing countries. Botswana's balance of payments position is forecast to remain strong, and a further rise is projected in the nation's gross official reserves. The budget for 1986/87 is another good omen, with a surplus equivalent to 14 percent of GDP.

The medium-term prospects for the economy appear to be "relatively bright," to use the words of the staff. However, they have also reported that the authorities remain concerned about the narrow base of the economy which leaves the country vulnerable to external developments. This is why the authorities continue to emphasize policies aimed at diversification of the economy with the hope of accelerating employment opportunities, expanding the revenue base and promoting rural development. The basic economic strategy is being carried out within the context of medium-term development plans--the present one covering the period 1985/86 to 1990/91--which serve as guideposts for decision-making.

Planning for the real sector of the economy is being supported by efforts to stabilize the financial position of the public sector. Thus, despite the strengthening of Government finances in recent years, the authorities are mindful of the need to control expenditure during the present period, especially on projects which are likely to generate large recurrent costs. At the same time, steps are being considered to increase revenue, although for practical reasons any significant change would depend on the success that is achieved in the drive to diversify the economy. The authorities remain aware of the importance of continuing with the policy of requiring public corporations to operate on a sound financial basis so as not to become a burden on the budget. At the moment, only a few corporations are experiencing difficulties, and the consolidated account has shown overall surpluses since 1980/81.

The agricultural and manufacturing sectors are receiving priority attention in the Government's development strategy. In agriculture, the aims are to achieve self-sufficiency in food grains and to expand employment in rural areas. These are being pursued largely under the umbrella of the Arable Land Development Program, which was introduced in 1980. It is encouraging that the use of this program by farmers has continued to increase since the 1983/84 crop season, although its effectiveness has been impaired by the drought. Toward the end of 1985, another program--the Accelerated Rainfed Arable Program--was launched to assist farmers in purchasing seeds and draft power. In addition to these financial schemes, the Government is adhering to the policy of maintaining remunerative prices for farmers. The Botwswana Agricultural Marketing Board announces producer prices ahead of the planting season to induce farmers to make their decisions with reasonable certainty about what their efforts are likely to yield by way of income.

As for the manufacturing sector, the authorities are doing whatever they can to improve the climate for domestic and foreign investment. Encouragement is being given to activities to increase exports and import substitution. The industrial strategy is being helped by Botswana's liberal licensing and exchange control policies as well as by several organizations, such as the Botswana Development Corporation, the Business Advisory Services, and the Trade and Investment Promotion Agency, which provide financial and technical assistance to private investors.

The diversification effort is also being extended to the tourist sector, and programs are under way to expand and improve game reserves, hotels, and transportation facilities. There is good potential in tourism, as evidenced by the nearly 50 percent increase in the number of tourists visiting Botswana between 1981 and 1984.

The banking system continued to be characterized by high liquidity, due primarily to the strong growth in export proceeds from the sale of diamonds and limited outlets for lending. The main task, therefore, is to find means through which the surplus liquidity can be transferred into productive investments. Accordingly, the authorities are examining the possibility of developing suitable debt instruments with appropriate maturities for the private sector and public corporations.

As noted earlier, estimates show that Botswana's balance of payments position improved in 1985. The current account surplus expanded from about SDR 10 million in 1984, equivalent to 0.9 percent of GDP, to SDR 120.6 million, equivalent to 13.2 percent of GDP. The overall balance of payments surplus increased from SDR 124.9 million to SDR 240.2 million. This success reflects not only the rapid increase in earnings from diamond exports, but also the Government's policy of seeking external financing mainly on concessional terms. Given the moderate pace projected for imports and exports, it is expected that the balance of payments will continue to register large, though diminishing, surpluses for the remainder of the decade.

Although the Government and public corporations have engaged in extensive borrowing since 1982 in order to finance a number of large-scale infrastructural projects, including the expansion of the Gaborone dam and the international airport, Botswana's debt service ratio remains relatively low. Even when account is taken of accrued but unpaid interest, the debt service ratio was only 12 percent in 1985.

> The authorities are committed to a flexible management of the exchange rate. In 1985, the effective exchange rate of the pula depreciated by 13 percent in real terms. To lessen the impact of accelerating inflation from South Africa, the major source of Botswana's imports, effective January 20, 1986 the relative weight of the rand in the currency basket used for determining the exchange rate of the pula was reduced from 75 percent to 65 percent, while that of the SDR was raised from 25 percent to 35 percent. This is a further indication of the country's pragmatic approach to economic management.

Mr. Mawakani said that the authorities were to be commended for the good management of their economy, which had continued to perform well in 1985: for the fourth consecutive year, real GDP was estimated to have grown by more than 10 percent, and substantial surpluses had been registered in both the internal and external accounts. Moreover, the projections indicated that the medium-term prospects remained favorable. The economic environment should help the authorities in their continued efforts to diversify the economy. The Sixth Development Plan correctly emphasized the promotion of agricultural development and small-scale manufacturing. Weather conditions over the previous several years had not helped the authorities' efforts to increase agricultural output, but those efforts should be maintained, and the supplementary irrigation projects that were designed to increase the water supply were appropriate.

The authorities' fiscal management had been prudent, Mr. Mawakani remarked. The fiscal surplus in 1986/87 was estimated at 16 percent of GDP. However, as the staff had noted, the authorities needed to diversify the tax base, which was concentrated excessively on the mineral sector. The authorities should give serious consideration to the proposals that had been made by the Fund technical assistance mission in September 1985; they were aimed at broadening the tax base, reducing the dependence on mineral-related receipts, and improving the stability of the fiscal system. Under the Sixth Development Plan, the authorities intended to increase expenditure on education and health facilities. That policy would help not only to redistribute the wealth from the mineral sector to the various sectors of the population, but also to improve the quality of life of the people and increase output. Given the able manner in which the authorities had managed the economy thus far, he was confident that they would continue to exercise firm control over the increase in expenditure that the new social services would entail.

He agreed with the staff that the authorities should develop new financial instruments to absorb the excess liquidity in the economy, Mr. Mawakani commented. Finally, the authorities were to be commended for the flexible exchange rate policy, which had enabled the export sector to maintain its competitiveness, and for their maintenance of a trade and payments system that was virtually free of restrictions. The proposed decision was acceptable.

Mr. Foot said that the authorities had been able to take advantage of the country's mineral wealth through the maintenance of generally prudent economic and financial policies. Despite the drought and the volatility of economic conditions in South Africa, Botswana had recorded an encouraging growth rate of nearly 11 percent in 1985 together with a substantial balance of payments surplus. Despite those successes and the revival of the strength of the diamond market--higher prices had recently been announced by the Central Selling Organization--longer-term issues needed to be faced. On the fiscal side, two needs clearly should be met. First, the tax base should be enhanced. As the staff had clearly shown, the share of mineral-related taxes in total revenues was likely to reach nearly 60 percent in 1986/87, and the authorities had received technical assistance from the Fiscal Affairs Department regarding ways in which that problem could be tackled. Second, expenditure should be kept under rigorous control and priority should be given to capital expenditure, which would underpin the authorities' efforts to diversify the production base of the economy. The proposed changes in the civil service salary structure were a cause for concern, especially as current spending was already planned to increase roughly twice as fast as capital spending. Development spending was not the only or the most important single way in which to diversify the production base, but room for the needed capital spending must be provided. From the example of other countries civil service pay increases could be poorly handled and could have major adverse implications for the private sector.

As to monetary policy, the staff report clearly showed that the banking system was very liquid, as domestic lending opportunities for banks apparently had been limited both by the economic situation and the banks' fear that their deposit base was not sufficiently stable to permit them to make long-term loans, Mr. Foot remarked. The thrust of the advice that had been given to the authorities by the Central Banking Department should be followed. If the Central Bank could encourage trading in a range of financial instruments that the banks were likely to be willing to hold, the financial system would receive a direct benefit, and the Central Bank would be able to convince the commercial banks through its intervention policy that the liquidity effects of any withdrawal of commercial bank deposits could be offset by the Central Bank's money market operations. If that approach were not possible, the second best approach would be a form of government deposit with the banking system, preferably along the lines of the tax and loan accounts typical in the United States rather than the approach mentioned in the staff report, namely, having the Central Bank make a large, long-term and inflexible deposit. The banks needed to be given assurance of the continuity of management and of the availability from the Central Bank of liquidity if problems were to arise, but the Central Bank should not tie the commercial banking system to it in any way--for example, by making the commercial banks seem to be beholden to government finance on a large scale. The longer the authorities ran the highly desirable budget surplus, the larger the problem in the monetary policy area was likely to become. Future staff reports on

Botswana should examine the relationship between the volatility in South African interest rates and the monetary policy choices available to the Botswana authorities.

The baseline projection of large, albeit diminishing, balance of payments surplus together with a high level of reserves was encouraging, Mr. Foot commented. He agreed with the staff that there was no clear need yet for a further increase in reserves. However, it was clear that exports were concentrated excessively on diamonds, and the major soda ash project was not a certain success. Future staff reports on Botswana should continue to examine closely the authorities' export diversification program.

A further comment on the status of the losses that had been incurred by the operators of the copper-nickle mine--Bamangwato Concessions, Ltd. (BCL)--would be helpful, Mr. Foot said. As he understood it, 20 percent of BCL was owned by the Government, and he wondered whether the Government viewed the losses and the arrears on the external debt of BCL as, in the last resort, a potential government obligation.

Mrs. Walker stated that she agreed with Mr. Abdallah that the economy had continued to make remarkable progress in 1985. Part of the progress was due to positive developments in the diamond sector, on which the economy was highly dependent, but part of the progress was also due to the Government's sound policies. The medium-term prospects for the economy appeared favorable, and the authorities should take that opportunity to develop further the private sector, reduce recurrent expenditure, develop monetary instruments, and continue their efforts to diversify the productive capacity of the economy. The favorable economic climate should provide the scope that was needed to achieve a more broad-based foundation for continued economic growth and development. The cooperation between the Fund and the World Bank in providing advice to Botswana on economic and financial matters was welcome.

The authorities' continued conservative fiscal policy was welcome, Mrs. Walker said. The budget surplus had increased to 18 percent of GDP in 1985/86. The budget estimates for 1986/87 showed a somewhat smaller overall surplus, and current expenditures were expected to rise by 21 percent, excluding the possible increase in salaries and wages effective April 1, 1986. The growth of recurrent expenditure had risen from an average annual rate of 18 percent in 1981/82-1983/84 to 25 percent in 1984/85-1986/87, and the staff had estimated that it would continue to accelerate in the medium term. She agreed with the staff that the growth of recurrent expenditure should be carefully monitored and controlled, and she was pleased that, as Mr. Abdallah had noted, the authorities were aware of the need to control expenditures, especially recurrent expenditure. The authorities should maintain their policy of wage restraint, especially as the Government was the largest single employer--accounting for 20 percent of total wage employment--and set an example for wage developments in the private sector.

During the previous Article IV consultation with Botswana, Executive Directors had commented on the need to introduce financial instruments to absorb the excess liquidity in the economy, Mrs. Walker recalled. There appeared to be a scarcity of long-term credit in the public and private sectors. Parastatals and other enterprises had borrowed abroad to finance their investment. Development of financial instruments together with a more flexible interest rate policy could help to direct the excess liquidity toward needed investment finance.

The authorities' continued attention to diversification of the economy in their development plans was welcome, Mrs. Walker said. For such diversification to occur, however, greater emphasis must be placed on developing the private sector. Private sector--other than parastatal--outlays were not included in the development plan. The staff had noted that the Government wished to establish a clear and stable environment to encourage private initiative, and a further comment on the steps that the Government was taking to encourage private sector activity, particularly in the context of the efforts to diversify the economy that were highlighted in the development plan, would be welcome. A cautious approach to the expansion of the Government would help to provide room in which private sector growth could occur.

The authorities' commitment to use price incentives to encourage agricultural production was appropriate, Mrs. Walker remarked. She welcomed the authorities' wish to improve the climate for domestic and foreign investment in the manufacturing sector through liberal licensing and exchange control policies as well as through the organizations that provided financial and technical assistance to private investors.

The balance of payments had recently registered large surpluses, and the staff had projected continued surpluses in the near future, Mrs. Walker noted. The flexible exchange rate policy had helped exports, and she welcomed the authorities' intention to maintain that policy in the future. The volume of reserves was substantial, and the authorities should begin substituting reserves for external borrowing to finance projects. She hoped that the authorities could continue to take advantage of the favorable economic situation and would achieve their long-term objectives concerning the diversification and development of the economy with greater involvement of the private sector.

The staff representative from the African Department said that the BCL was registered as a domestic company, of which 20 percent of the equity was owned by the Government. Although it had borrowed externally, it was the domestic currency equivalent of the external debt that should be considered. The Government regarded the losses as a charge in terms of local currency rather than in terms of foreign currency.

In its efforts to diversify the economy the Government had relied mainly on providing an investment climate that was conducive to foreign investment, including a relatively free and liberal exchange system and the freedom to export dividends, the staff representative explained. In addition, the authorities had implemented a financial assistance policy that was aimed at encouraging entrepreneurship and had provided training for workers in the manufacturing sector. The authorities were making a variety of efforts to diversify agricultural output. A number of institutions, including the Botswana Development Corporation, the National Development Bank, and the Botswana Enterprise Development Unit, were designed specifically to encourage initiatives in the private sector.

Interest rates in South Africa had been falling during the previous year, and especially the previous six months, the staff representative from the African Department noted. Real interest rates in South Africa had fallen and, as a result, real interest rates in Botswana exceeded those in South Africa. Accordingly, the Botswana authorities had not felt pressed to increase interest rates in Botswana to prevent capital outflows to South Africa or to attract capital from South Africa. Indeed, the substantial liquidity in Botswana's economy had made it unnecessary for the authorities to attract South African capital by increasing interest rates in Botswana.

Mr. Abdallah remarked that Executive Directors clearly appreciated the commendable performance of the economy and authorities of Botswana.

The Chairman made the following summing up:

> Directors broadly concurred with the views expressed in the staff appraisal for the 1986 Article IV consultation with Botswana. They warmly commended Botswana's impressive economic and financial performance, including strong economic growth, relative price stability, and substantial budgetary and balance of payments surpluses in recent years. Directors observed that this was due both to the buoyant diamond market and to good economic management.
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> Directors noted that Botswana's balance of payments position was projected to remain strong in the medium term. They commended the authorities' efforts to diversify the economy by developing alternative export and import substitution activities, particularly in agriculture and small manufacturing, with a view to reducing Botswana's heavy dependence on diamonds. In this context, Directors welcomed the flexible use of the exchange rate and of a realistic domestic pricing policy and stressed the need for Botswana to maintain a competitive position in external trade.
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> In the fiscal area Directors noted favorably the substantial budgetary surpluses realized by the Government in recent years and emphasized the need to continue to contain vigorously the growth in recurrent expenditure; in that context, particular care needed to be exercised with regard to the civil service pay policy. They urged a broadening of revenue sources along the

lines suggested by the fiscal technical assistance mission with a view to reducing the increasing reliance on mineral-related revenues and providing greater stability to the fiscal system.

Directors encouraged the authorities to achieve a judicious balance between the accumulation of foreign reserves and foreign borrowing. In the area of monetary policy, they encouraged the authorities to develop appropriate financial instruments so as to improve financial intermediation and to absorb excess liquidity in Botswana.

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

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Botswana, in the light of the 1986 Article IV consultation with Botswana conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Botswana continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions except for relatively liberal limits which apply to private and business travel and remittances abroad that are maintained in accordance with Article XIV, Section 2. The Fund encourages Botswana to remove these remaining restrictions as soon as possible.

Decision No. 8278-(86/77), adopted
May 6, 1986

3. NICARAGUA - 1986 ARTICLE IV CONSULTATION - POSTPONEMENT

Without discussion, the Executive Directors accepted the request by Mr. Pérez to extend the period for completing the 1986 Article IV consultation with Nicaragua to not later than May 16, 1986.

The Executive Board then took the following decision:

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1986 Article IV consultation with Nicaragua to not later than May 16, 1986.

Decision No. 8279-(86/77), adopted
May 6, 1986

APPROVED: January 23, 1987

LEO VAN HOUTVEN
Secretary