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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/101

10:00 a.m., June 23, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	M. Lundsager, Temporary
	H. G. Schneider
	G. Ercel, Temporary
	T. Alhaimus
H. Fujino	
	B. Goos
	Yang W., Temporary
J. E. Ismael	
A. Kafka	
	M. Foot
H. Lundstrom	
M. Massé	G. D. Hodgson, Temporary
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	
	J. E. Suraisry
	G. Ortiz
H. Ploix	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
	H.-S. Lee, Temporary
	O. Kabbaj
A. K. Sengupta	A. Vasudevan, Temporary
S. Zecchini	

L. Van Houtven, Secretary
S. L. Yeager, Assistant

Also Present

IBRD: H. H. Reichelt, B. Varon, Western Africa Regional Office; P. R. Scherer, Latin America and the Caribbean Regional Office. African Department: A. D. Ouattara, Director; M. Allen, E. L. Bornemann, S. E. Cronquist, L. D. Dicks-Mireaux, J. R. Hill, B. P. Ledoux. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; M. Guitián, Deputy Director; J. Berengaut, E. H. Brau, S. Kanesa-Thasan. Fiscal Affairs Department: C. Schiller. Legal Department: H. Elizalde, J. M. Ogoola, S. A. Silard, J. V. Surr. Treasurer's Department: A. J. Mathuran. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; H. Arbulu-Neira, C. V. A. Collyns, J. Ferrán, B. C. Stuart. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, L. K. Doe, L. P. Ebrill, J. Hospedales, G. Nguyen, D. C. Templeman, N. Toé, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, M. Arif, A. Bertuch-Samuels, B. Bogdanovic, J. de la Herrán, F. Di Mauro, R. Fox, L. Hubloue, O. Isleifsson, J. M. Jones, S. King, T. Morita, W. K. Parmena, J. E. Rodríguez, V. Rousset, D. Saha, S. Simonsen, H. van der Burg, B. D. White.

1. COTE D'IVOIRE - 1986 ARTICLE IV CONSULTATION AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1986 Article IV consultation with Côte d'Ivoire, together with a request for a two-year stand-by arrangement in an amount of SDR 100 million, equivalent to 30.2 percent of quota on an annual basis (EBS/86/113, 5/28/86; and Cor. 1, 6/18/86). They also had before them a report on recent economic developments in Côte d'Ivoire (SM/86/128, 6/10/86).

The staff representative from the African Department reported that since the staff paper had been issued, the Executive Board of the World Bank had approved on June 3, 1986 a third structural adjustment loan for an amount of $250 million in support of the authorities' structural adjustment efforts. On May 12, 1986, the Ivoirien authorities had agreed with the steering committee of Côte d'Ivoire's commercial creditors on the terms and conditions of the refinancing of principal due over the four-year period 1986-89. The Paris Club was scheduled to consider the authorities' request for a multiyear debt rescheduling on June 26-27. He understood that both the commercial banks and the Paris Club creditors would seek suitable monitoring arrangements for the period beyond the expiration of the proposed stand-by arrangement. At its meeting on July 1, 1986, the Board of Directors of the BCEAO were expected to consider Côte d'Ivoire's request to consolidate the outstanding accidental overdrafts of the five specialized banks experiencing difficulties. Finally, the target of maintaining domestic currency reserves of CFAF 40 billion at the level of the Caisse Autonome d'Amortissement (CAA) and the Treasury had been observed with a comfortable margin as of end-May.

Mr. Alfidja made the following statement:

> The perseverance in the implementation of adjustment measures by the authorities of Côte d'Ivoire has led to significant progress on many fronts. In particular, economic growth resumed in 1985 at a stronger pace than anticipated, the budgetary and external accounts improved markedly, and inflationary pressures eased further. Furthermore, all of the performance criteria under the stand-by arrangement that expired on June 2, 1986 were observed.
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> The strong expansion of the economy in 1985 reflected chiefly the rapid growth of agricultural output and, to a lesser extent, an improvement in industrial activity. The price adjustments of the major export crops as well as of some food crops, notably rice, that have taken place in 1985 together with improved weather conditions contributed to a rise in agricultural production.
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> The adjustment efforts of the authorities have also had a beneficial impact on the budgetary position, which shifted from a deficit equivalent to about 3 percent of GDP in 1984 to a

surplus of almost 4 percent of GDP in 1985. Instrumental in bringing about this shift were measures to expand revenue and rein in government spending. On the revenue side, the Treasury benefited from a considerably larger transfer from the public enterprise sector, which recorded large surpluses, and from the Stabilization Fund. In addition, a substantial increase in tax revenue was registered, thanks to the favorable impact of tax measures introduced earlier under the 1984 financial program and a strengthening of the tax administration. Efforts on the expenditure front were as central to the improvement in public finances in 1985 as was the revenue growth. For example, the wage bill was frozen for the third consecutive year, and steps were taken to contain expenditure out of extrabudgetary accounts. As reported by the staff, the improvement in the fiscal situation enabled the Government to eliminate all existing identified external payment arrears and to reduce significantly domestic payment arrears.

Monetary and credit policies remained restrictive in conformity with the general stance of controlling aggregate demand. In fact, net credit to the public sector declined by 15 percent. The financial position of the major commercial banks improved. However, the losses of the specialized banks rose despite the corrective measures taken to stem the deterioration of their financial situation.

The prudent and restrictive fiscal policies pursued by the authorities combined with the effect of the debt relief granted by foreign creditors contributed to an improvement in the overall balance of payments. The authorities recognize that not only would the debt service absorb a significant proportion of the country's export earnings but the volatility of prices of their major export commodities would also make the adjustment process more difficult. These and other factors underscore the fragility of the gains achieved so far. It is, therefore, against this background that my authorities are embarking on a two-year financial program for which they are seeking Fund and Bank assistance.

The new program aims at strengthening the underlying economic situation through prudent financial policies, increasing the competitiveness of the agricultural and industrial sectors, and rehabilitating and restructuring public enterprises. Further efforts will be made to broaden the base of the economic expansion. In response to the policy of gradual increases in producer prices, agricultural output is expected to rise with coffee and cocoa production projected at 280,000 and 520,000 tons, respectively. Furthermore, additional steps will be taken to upgrade extension services.

Efforts to consolidate gains in the fiscal sector will continue despite the projected decline in total revenue owing to an anticipated drop in transfers from the Stabilization Fund. Partly to mitigate this unfavorable development, my authorities are discussing with a Fund mission currently in Abidjan the possibility of introducing new tax measures. Regulations governing tax exemption and temporary admission will be tightened with a view to broadening the tax base. Efforts to strengthen tax administration are being reinforced. On the expenditure side, current and capital expenditure will be raised. This increase, however, should not be interpreted as a relaxation of the authorities' adjustment efforts. The rise in current outlays reflects essentially the provision for the restructuring plan of the specialized banks. Following three consecutive years of a freeze, the wage bill is forecast to rise to accommodate salary increases for promotions granted earlier without financial disbursement. New civil service recruitment is to be limited to graduates from administration schools whose enrollment will be reduced gradually over the years. As a result, the rate of growth of the civil service is estimated to decline in the years to come. The Government's efforts to reduce the burden of the public enterprises on government finances will be intensified in 1986. Anticipating a less favorable medium-term financial outlook for the EECI, the electricity agency, a study is under way with a view to putting in place a restructuring plan. SOGEFIHA, the housing agency, will be liquidated and the proceeds from the sale of its assets are to be used to repay its debt. The subsidy to SOTRA, the Abidjan Transit Authority, will we capped. Finally, ONT, the telecommunications agency, will be rehabilitated with financial assistance from foreign creditors.

Similar structural measures will be implemented in the banking sector to deal with the deteriorating financial situation of the five specialized banks. A rehabilitation plan to this effect has been adopted. It will consist of a consolidation of the overdraft with the BCEAO, a reinforcement of the supervision of the banks, a decrease in their operating costs and, finally, an increase in the capital base of these institutions. While a large proportion of the cost of restructuring will be borne by the Government, the plan has been designed in such a way as to minimize its impact on the fiscal deficit.

In the external sector, as reported by the staff, a current account deficit would emerge in 1986 compared with a surplus in 1985 largely owing to the decline in the world prices of cocoa and cotton, which would not be entirely offset by the effects of the increase in coffee prices. Measures are being implemented to overcome the overdependence of the external sector on coffee and cocoa and to increase the competitiveness of the manufacturing sector.

To conclude, it should be noted that past successful implementation of adjustment programs has been undertaken at a high social cost, including an increase in unemployment and a decline in purchasing power in urban areas. My authorities believe that policies designed to restructure the economy should be growth oriented. In that regard, the continued support of private and official creditors as well as multilateral financial institutions is critical, as a useful adjunct to local savings for the financing of the investment that will lead to sustained economic growth.

Mrs. Ploix said that recent developments in Côte d'Ivoire were encouraging and that she strongly supported the proposed decision. The improvement in the country's economic and financial situation reflected a long and courageous adjustment effort. Gains in 1985 were substantially greater than initially forecast: the increase of GDP by 4.9 percent indicated the resumption of growth, which was taking place within a well-controlled financial and macroeconomic framework. Moreover, the rate of inflation had been limited to about 2 percent, while both public finance and external current accounts had recorded surpluses.

The general and substantial economic improvement in Côte d'Ivoire had been achieved through comprehensive adjustment efforts undertaken since 1981, Mrs. Ploix continued. Those efforts had been supported in a substantial and coordinated way by both the Fund and the World Bank. Since 1981, Côte d'Ivoire had had an extended arrangement and two stand-by arrangements with the Fund, with total cumulative disbursements of SDR 574 million. During that same period, the World Bank had committed SDR 964 million, of which SDR 400 million had been related to structural adjustment. The magnitude of financing clearly illustrated that a country committed to a convincing, strenuous adjustment program could mobilize extensive support for its endeavors. It also showed that close cooperation between the Fund and the World Bank could be a central element to ensure the success of the adjustment strategy; in Côte d'Ivoire, it had helped to achieve a proper balance between demand restraint and supply-oriented action.

Côte d'Ivoire exemplified a country that was continually designing and successfully implementing far-reaching structural policies, Mrs. Ploix considered. Notwithstanding the favorable outcome thus far, the authorities were aware that the financial situation would remain tight and fragile owing to the large external public debt service and the country's dependence on coffee and cocoa exports. She therefore fully supported the program in support of the stand-by arrangement and the adjustment measures aimed at strictly containing the overall public sector deficit and limiting the extent of the current account deficit, while at the same time improving the quality of the public investment program.

On the fiscal side, she fully agreed with the steps taken by the authorities to broaden the tax base so as to alleviate the vulnerability of public finance to export earnings from cocoa and coffee and to ensure that, despite world price fluctuations for those commodities, the Caisse Autonome d'Amortissement would have permanent sources of revenue to cover at least the interest payments on external and domestic debt, Mrs. Ploix commented. The new tax on refined petroleum was timely and would contribute substantially to that objective. As to expenditure, she noted with satisfaction that as a result of the progress achieved in redressing the financial situation of the public enterprises, transfers from the Government to those entities would be reduced by 30 percent. Moreover, those enterprises were at present in a position to repay their debt on schedule without benefit from the impact of external debt rescheduling. She welcomed the adoption of a program of action to address the problem of the specialized banks, as had been recommended by the Board on previous occasions.

The supply-side reforms designed to foster the competitiveness of the agricultural and industrial sectors could not be overlooked in view of the close links existing between the Fund and the World Bank adjustment programs, Mrs. Ploix remarked. Indeed, those reforms were at the core of Côte d'Ivoire's overall development strategy and represented a step toward reaching the medium-term real growth target of 4 percent per annum. By reducing and unifying the level of protection for the industrial sector, while at the same time bringing the level of net effective protection to unity in the agricultural sector, the program aimed at progressively eliminating many of the existing distortions and promoting a sounder allocation of resources between the agricultural and industrial sectors as well as within the industrial sector itself. She fully agreed with that approach, because the distortions resulting from an overprotected industrial sector and a relatively underprotected agricultural sector had led to a transfer of resources from a viable, potentially rich rural sector to inefficient industries which were not encouraged to compete nor to improve their productivity. Recent experience with rice production had demonstrated the quick, positive response of the agricultural sector to incentives. She was therefore confident that the authorities' policy package would yield the expected result and, by diversifying agricultural production, would contribute to reduce the country's reliance on coffee and cocoa. In the industrial sector, the effectiveness of those measures would depend primarily on the response of private entrepreneurs. The World Bank could also play a greater role in that area through its subsidiary, the International Finance Corporation, by promoting investment flows from industrial countries to Côte d'Ivoire in association with Ivoirien entrepreneurs.

Building on those policies and achievements, the Ivoirien authorities had devised a medium-term strategy to resolve the country's debt crisis, Mrs. Ploix continued. The heavy burden of debt contracted between 1986 and 1980 remained a major constraint for Côte d'Ivoire. Thus, in addition to its objectives of continuing adjustment and achieving sustained growth, Côte d'Ivoire expected to return to normal relations with external creditors by the beginning of the next decade. That objective was to be achieved by improving the debt profile through increased efforts to mobilize external resources on concessional terms and by strictly limiting external nonconcessional borrowing. At the same time, Côte d'Ivoire would begin to make substantial net repayments, gradually reducing the amount of rescheduled debt. Net repayments to the Fund would reduce Fund credit outstanding to Côte d'Ivoire from 336 percent of quota to 254 percent of quota during the period of the proposed arrangement.

From 1986 to 1992, the period covered by the medium-term scenario, Côte d'Ivoire's debt strategy called for a decline of the ratio of external public debt outstanding to GDP from 37 percent to 43 percent and a decrease of the service ratio to public sector revenue from 42 percent to 34 percent, Mrs. Ploix observed. However, considering the high vulnerability of the economy to external factors, the creation of a small reserve fund of CFAF 40 billion earmarked for limiting the impact of such factors was fully warranted and would enable the country to realize its growth prospects.

Mr. Hodgson said that following three years of economic performance below potential, Côte d'Ivoire had made impressive and important gains during the past two years. Those gains could be attributed in part to improved external circumstances, but also in part to a strengthening of adjustment efforts during 1984. Consequently, Côte d'Ivoire had exceeded all expectations for 1985 in terms of reducing domestic imbalances and returning to strong economic growth. It was commendable that both the external and public sector accounts were substantially stronger than originally projected and that real GDP growth had increased to almost 5 percent.

Despite those gains, the country's medium-term prospects were clouded by three constraints: the high level of debt service; the heavy reliance upon volatile cocoa and coffee export earnings; and the limited diversification of the economy, Mr. Hodgson observed. The authorities would have to maintain strong adjustment policies for the balance of the decade if renewed growth was to become well rooted and if the external accounts were to become fully sustainable. He therefore supported the request for a two-year stand-by arrangement, which should assist the authorities in maintaining the strong adjustment momentum that had already been achieved. He noted that the program entailed a reduction in Côte d'Ivoire's obligations to the Fund by an amount equivalent to almost 80 percent of quota; that seemed a reasonable way of reducing the country's relatively high level of credit outstanding to the Fund, while at the same time ensuring that adjustment measures remained strong and on course.

The financial program for 1986 in support of the stand-by arrangement correctly emphasized the continuation of the strong demand management policies that had already been implemented, Mr. Hodgson considered. For example, the overall public sector deficit was expected to be entirely financed by net foreign resources, and the authorities would take advantage of the recent reduction in oil prices to increase government revenues by not reducing domestic petroleum prices. He welcomed the measures aimed at reducing ad hoc exemptions from tax and import duties, which would help to increase government revenues and improve resource allocation across the economy. On the expenditure side, the plan to rationalize government wage policy by reducing the overall wage bill, while simultaneously increasing individual wages through greater incentives, was an intelligent tradeoff. The authorities' efforts to set firmer priorities for public sector investment by concentrating on projects with high rates of return, and to reduce the stock of domestic arrears were also encouraging.

He agreed with the staff that a cautious credit policy was required to achieve balance of payments equilibrium and that an action program to restructure the specialized banks experiencing difficulties was necessary, Mr. Hodgson added. In general, improved financial intermediation should help mobilize domestic savings.

More important, the adjustment program for 1986 concentrated on measures to improve the supply capacity of the economy, thus improving prospects for economic growth over the medium term, Mr. Hodgson remarked. He endorsed the medium-term growth strategy set out in the stand-by arrangement, which intensified supply policy reforms previously introduced under two structural adjustment loans with the World Bank. One key area of Fund-Bank collaboration was reform of the structure of incentives within the economy. Those reforms included an increase in coffee and cocoa producer prices, the phasing out of import subsidies and export taxes on diversification crops, and the improvement in the compensation scheme for those crops within the context of World Bank structural adjustment lending. The liberalization of the tariff structure to reduce net effective protection by some 40 percent, and thereby increase competition within domestic markets, was also welcome.

The Ivoirien authorities had good reason to be satisfied with the progress made during the past two years, Mr. Hodgson commented. If that progress could be sustained and continuing efforts were made to improve the economy's supply capacity, the country should be able to re-establish a self-financing balance of payments position around the end of the decade. Nevertheless, the economic and export base remained relatively narrow with a high degree of dependence upon unstable world coffee and cocoa prices. That instability provided good reason for continuing tight control of domestic demand while concurrently fostering conditions for more broadly based economic growth. Those circumstances warranted the proposed stand-by arrangement, and he supported the proposed decision.

Mr. Wijnholds stated that, aided by unexpectedly favorable external developments, Côte d'Ivoire's adjustment program had been very successful during 1985. The growth rate of real GNP, the surpluses in the balances of the public sector and the current account, the inflation performance, and the reduction in domestic and external arrears were impressive. All performance criteria under the program had been met, and some by a large margin. After the disappointing results under previous stand-by arrangements, that outturn was most welcome. Since 1980, the Ivoirien adjustment effort had, on balance, been rather successful and compared favorably with the adjustment of other debtor countries as described by the staff in the paper on recent economic developments.

Considering the success of the adjustment effort thus far, the medium-term projections were disappointing, Mr. Wijnholds commented. Although improvements were projected for all key variables, such as public finances, the balance of payments, and growth rates of GNP, those improvements seemed rather gradual. As a consequence, the additional financing requirements remained relatively substantial throughout the decade. Also, in view of the aim to diversify the economy and expand the export base beyond the traditional exports of cocoa and coffee, the projected growth rate of only 3.5 percent for other exports in the coming years was modest. He wondered whether the staff's observation that supply would respond only slowly to ongoing reforms was not too pessimistic. After all, reforms had been implemented for a number of years; some non-traditional agricultural activities, like rubber, pineapples, and bananas, had reacted quite rapidly to structural improvements; and the manufacturing sector had expanded rapidly in the 1960s and 1970s. Therefore, he asked the staff to further clarify its view on the economy's supply response.

He fully supported the stand-by arrangement, which should contribute importantly to further progress toward a viable external position and a normalization of Côte d'Ivoire's relationship with its creditors, Mr. Wijnholds remarked. As to the program in support of the arrangement, it was clear that the surpluses of the stabilization fund would remain an important source of government revenue, although their importance was expected to decline gradually. The continued reliance on those revenues implied that government finances would remain dependent on the behavior of the external sector and also suggested that a considerable margin still remained between domestic producer prices and world market prices for those goods under the direction of the stabilization funds. An important goal of further adjustment should be to lessen that dependence. He therefore wished to stress the importance of both revenue-raising measures and spending restraint. In view of the widespread use of ad hoc exemptions of taxes and import duties, some scope existed for strengthening tax collection. As to spending restraint, while the decisions to increase the salaries of civil servants and to expand public investment were understandable, a cautious approach was needed with respect to the total wage bill. Likewise, although the financial situation of the public enterprises had improved considerably, those entities remained dependent on the government budget for their investments. It was important that, if feasible, those enterprises become financially independent of the government budget and responsible for their own finances, possibly as a first step toward a greater involvement of the private sector in relevant public enterprises.

The decision to reduce the net effective protection of domestic industries was welcome, but, at 40 percent, the level of protection still seemed high, Mr. Wijnholds continued. Indeed, a gradual opening of the economy to international competitive forces as well as to direct foreign investment could greatly benefit the country's growth potential.

Côte d'Ivoire had made important progress during the past few years, but remained vulnerable to external developments, Mr. Wijnholds commented. The program would build upon that progress and lessen that vulnerability. Therefore, he fully supported the stand-by arrangement. In view of Côte d'Ivoire's high level of Fund credit outstanding and its prolonged use of Fund resources, the authorities might wish to exercise restraint with respect to actual drawings on the Fund, if external conditions permitted.

On a general issue, he noted that the staff had assumed that commodity prices would move in line with the U.S. dollar exchange rate, Mr. Wijnholds added. He recognized that the staff preferred to err on the side of caution in such matters, but he wondered whether in practice such an assumption might not be too pessimistic. After all, one explanation for low commodity prices was the appreciation of the dollar. Was it not reasonable to expect that commodity prices would rise somewhat as a result of the substantial depreciation of the dollar?

Ms. Bush said that Côte d'Ivoire's performance as a result of its adjustment efforts had been positive. However, the favorable developments that had contributed in 1985 to exceptionally high levels of agricultural production, which had generated both fiscal and current account surpluses, were likely to be reversed to some extent in 1986, thereby heightening the need for economic diversification. Unfortunately, the composition of exports had not changed in five years, underscoring the need for broader efforts to stimulate supply. The authorities were making some welcome changes in that regard, including the phasing out of input subsidies and export taxes on diversification crops. In addition, the manufacturing sector was expected to grow by about 9 percent in real terms, partly owing to incentives to stimulate private sector investment. Those incentives seemed to focus on decreasing the role of government intervention in promoting one industry over another. She would appreciate staff comment on that observation and on whether the private sector stood ready to take advantage of those incentives.

The stabilization funds had generated large operating surpluses, which in 1985 were equivalent to 9 percent of GDP, Ms. Bush noted. Although the level of production had recently been high, producer incentives might be maintained and strengthened over the longer run through an enhanced role for competitive forces in the public enterprise sector. As there were some 250 nonfinancial public enterprises, scope seemed to exist for divestment and expanded private sector activity in some areas, similar perhaps to the privatization of the activities of the land servicing agencies. She welcomed the program to rehabilitate several major public enterprises, including the oil refinery, and the electricity, sugar, and telecommunications corporations, and also the liquidation of the housing agency.

Although the small deficit projected for 1986 did not appear to be a problem in view of the availability of financing, further consolidation of the fiscal effort was needed to provide adequate resources to the productive sectors, Ms. Bush remarked. Stronger efforts should also be made to reduce budgetary dependence on the stabilization funds. There was also scope for reducing current expenditures, which were equivalent to about 27 percent of GDP in 1985. Although some 8 percentage points of that amount were attributable to interest payments on external debt, the level of current expenditures remained relatively high. Moreover, while no general wage increase was scheduled, the higher pay schedules related to past promotions would go into effect later in 1986, resulting in an increase in the wage bill. Wages in Côte d'Ivoire were high relative to neighboring countries, and she hoped that the authorities would pursue a cautious wage policy to avoid undermining the measures being taken to encourage economic diversification and enhance the international competitiveness of the country's productive sectors. In that connection, the level of new admissions to the public administration schools had been reduced only marginally; she wondered whether it might not be more appropriate to further encourage vocational and technical training.

Monetary policy was supportive of the fiscal effort, and the adoption of the action plan for the five specialized banks was welcome, Ms. Bush commented. The authorities should increase participation of private banks in the ownership of the development and sector-oriented banks. She noted that the interest differential in favor of foreign markets had encouraged commercial banks to transfer funds abroad in 1984 and 1985. More attractive financial rewards were needed to discourage capital flight so as to provide the domestic resources needed to strengthen the domestic investment ratios. Private capital inflows amounting to CFAF 9 billion were projected for 1986; she wondered if that projection reflected a reduced interest rate differential or a more general return of confidence in the domestic economy.

After several difficult years, Côte d'Ivoire's recent good economic performance had helped to restore the confidence of the international financial community, Ms. Bush observed. That confidence was evidenced by the support being provided by the commercial banks' multiyear rescheduling package, the new stand-by arrangement with the Fund, the World Bank structural adjustment loan, and the expected rescheduling of the country's debt obligations by the Paris Club in the coming week. She hoped that the cooperative effort of Côte d'Ivoire's major creditors would be supported by the return of direct investment capital. She urged the authorities to continue their strong efforts particularly in the area of deregulation, which was important to encourage private sector activity both for domestic consumption and for export. The efforts to increase competitiveness, reform the public enterprises, and broaden the export base through supply-oriented measures should help encourage economic activity and further diversification. Like Mr. Wijnholds, she was concerned about the staff's views regarding the economy's slow response to supply-side measures. She expected that the measures would result in more efficient production and economic growth over the medium term and that in coming years, the resulting economic base could support a full normalization of relations with external creditors, thereby obviating the need for exceptional financing. With that goal in mind, she supported the proposed decision.

Mr. Zecchini said that Côte d'Ivoire had achieved commendable economic results in 1985. All performance criteria under the previous stand-by arrangement had been observed and the main economic objectives of the program had been attained, in many areas with comfortable margins. Specifically, the overall public sector account and the current account of the balance of payments had both recorded surpluses in 1985, after having been in deficit by more than 10 percent of GDP only two years previously. The adjustment effort had also been compatible with a pickup in real economic growth by 4.9 percent of GDP, after negative rates of growth in preceding years. Inflation had remained subdued.

In that context, he welcomed the authorities' continuing commitment to cautious economic management as shown by the request for a two-year stand-by arrangement, Mr. Zecchini continued. That request deserved the Board's full support: the program should allow a consolidation of the progress that had been made so far, and Côte d'Ivoire's good record of adjustment warranted continued Fund support. He agreed with the staff that Côte d'Ivoire's economic situation was less solid than it first appeared; owing to its sizable external debt and heavy dependence on a few agricultural exports, the country remained vulnerable to external shocks.

In the light of the country's prolonged use of Fund resources, the course of action chosen by the Fund staff was appropriate, Mr. Zecchini considered. While Côte d'Ivoire would continue to benefit from Fund support and advice under an economic program, annual access would be progressively reduced with respect to previous programs so as to allow net repurchases during the period of the stand-by arrangement. He noted with satisfaction that Fund credit outstanding was expected to decrease from 336 percent of quota to 254 percent of quota by the end of the arrangement. Moreover, in view of the country's need for continued structural reform, he welcomed the World Bank's active involvement through a structural adjustment loan.

He agreed with the thrust of the proposed arrangement and the staff's recommendations and wished to remark briefly on some aspects of the program, Mr. Zecchini commented. Regarding fiscal policy, the positive results that had been attained in 1985 had been partly due to a shortfall in capital expenditures and to large surpluses in the stabilization and equalization funds that were attributable to transitory factors. A reduction in capital expenditure did not seem advisable in view of the need to expand the capital base. To strengthen the fiscal position in a more durable fashion, emphasis was to be placed on increasing tax revenues through a tax on oil consumption so as to offset the negative impact of the oil price decrease on public finances; reducing tax and tariff exemptions; and strengthening tax administration and collection. He noted that a technical assistance mission had visited Côte d'Ivoire in June to further study revenue measures. He wondered whether any information was available on the findings of that mission and if the staff believed that without further action it would be possible to realize the increase in tax revenues that was projected in the program for 1986.

One of the main uncertainties that remained in the program related to possible ways of dealing with the losses of the five specialized banks, Mr. Zecchini noted. Those losses amounted to CFAF 116 billion, equivalent to about 3.8 percent of GDP. The program that had been announced to rehabilitate those institutions was welcome and should be given high priority. It was expected that the existing losses would be covered by the Government, but it was not clear from the staff paper whether any definite plans had been made for that purpose. He invited further comments on that point; specifically, he would like to know if any allowance had been made in the budget or in the program's fiscal targets for covering existing losses.

Mr. Goos remarked that performance under the present adjustment program had been excellent and the authorities deserved to be particularly commended for their strict adherence to the agreed adjustment path despite the temptation to ease the policy stance in the wake of the relatively favorable overall economic environment. Côte d'Ivoire's experience showed that adjustment did pay off, notwithstanding the exceptional factors, such as improvements in the terms of trade and favorable weather conditions, that had undoubtedly contributed to its success.

Nevertheless, those factors as well as a difficult medium-term outlook were a clear reminder that much remained to be done in order to achieve a viable overall economic position without exceptional support from external creditors, Mr. Goos commented. Against that background, the policies and objectives agreed under the new arrangement constituted an appropriate adjustment effort, although a more pronounced spillover into 1986 of the previous year's admittedly unexpected improvements in the external accounts might have been desirable. However, a further compression of public sector investment would have certainly been counterproductive, and he noted with satisfaction that, in general, policy targets had been set at more ambitious levels than those under the previous program. In view of the high debt service burden and the critical contribution of fiscal policy to overall stabilization in the context of the country's membership in the West African Monetary Union, the objective to achieve a fiscal surplus by 1988 was no doubt highly commendable. However, while acknowledging the limited flexibility of interest rate policy consequent to that membership, his authorities were concerned that present high real interest rates could pose considerable problems in the medium term.

The thrust of the structural policies agreed with the authorities was appropriate, Mr. Goos added. The trend to set producer and consumer prices at more realistic levels that reflected world market prices was particularly welcome. Obviously, the importance of such policies in promoting adjustment could not be overemphasized.

While the prospective weakening of the balance of payments in the coming two years seemed to justify the Fund's continued financial involvement in Côte d'Ivoire, he agreed with the staff that the decline in the Fund's exposure envisaged under the arrangement was warranted for the reasons mentioned in the staff paper, most notably the country's prolonged use of Fund resources, Mr. Goos remarked. Moreover, a decline in outstanding Fund credit was also justified in view of the progress that Côte d'Ivoire had already made in achieving a more balanced framework of macroeconomic policies. Accordingly, future stabilization efforts would have to focus increasingly on the remaining structural imbalances, which would be consistent with a greater role for longer-term financial assistance. As to financing the remaining balance of payments gap, he wondered to what extent, if any, the proposed outright approval of the stand-by arrangement would constitute a deviation from established practices. Finally, he supported the proposed decision.

Mr. Suraisry remarked that over the past few years the Ivoirien authorities had been making determined efforts to implement adjustment programs to restore economic equilibrium. Although significant swings in the external environment had complicated those efforts, the authorities had responded flexibly to changing circumstances. Consequently, all the performance criteria under the latest program had been met, and the economy was once again returning to a path where sustained growth should be possible.

He commended the authorities for those achievements, Mr. Suraisry continued. In particular, the complete elimination of external arrears and the sharp reduction in domestic arrears attested to the success of the measures they had adopted. However, it was important to sustain the momentum generated by those efforts. According to the medium-term scenario, the high level of debt service combined with the narrow export base implied that Côte d'Ivoire would continue to be vulnerable to external developments throughout the remainder of the decade. That vulnerability would require continued vigilance on the part of the Ivoirien authorities.

More specifically, he wished to reiterate his chair's concern that the underlying elasticity of the tax system was not very high, Mr. Suraisry remarked. The share of tax revenue as a percent of GDP had declined from more than 22 percent in 1981 to less than 19 percent in 1985. Even more important, the authorities continued to rely heavily on transfers from the stabilization fund as a source of revenue. At best, those transfers were volatile. If, as expected at present, coffee and cocoa prices were to be less buoyant than originally projected in 1986, government revenues would be depressed to that extent. That possibility suggested that the authorities might on occasion have to rely on discretionary tax increases, or further expenditure reductions, to compensate for unexpected shortfalls in stabilization fund revenues. Thus, the authorities should broaden their tax base and improve tax collection. In particular, he urged them to consider placing further limitations on ad hoc tax exemptions. In that connection, he was encouraged by Mr. Alfidja's statement that the authorities were committed to broadening the tax base.

On government expenditures, he encouraged the authorities to maintain their cautious approach, Mr. Suraisry commented. In that connection, the 9.2 percent increase in expenditures projected for 1986 significantly exceeded the expected rate of inflation. While some of the sources of that increase, such as the significant rise in public sector investment outlays, could perhaps be defended, the projected 12 percent increase in the public sector wage bill seemed large. He therefore encouraged the authorities to take all possible measures to restrain the growth of the civil service.

The structure of production in Côte d'Ivoire was heavily concentrated in a small number of commodities, Mr. Suraisry observed, with a particularly heavy reliance on coffee and cocoa for export revenues. Although he welcomed the authorities' intentions to enhance incentives in those sectors by--for example--providing annual increases in real producer prices, it was nonetheless important to encourage diversification. In particular, an environment must be created in which the private sector increased its contribution to economic activity. The proposal to generalize the industrial policy reform by reducing rates of net effective protection and equalizing incentives for exports and domestic sales was an important step in the right direction. However, more needed to be done in that area, and he invited the staff to comment on possible future actions.

The medium-term scenario envisaged a return to real growth rates of 4 percent a year in 1990, Mr. Suraisry remarked. That achievement was not so impressive when viewed in the context of an annual rate of population growth of 3.4 percent. In addition, investment levels in 1986--at 12 percent of GDP--were still well below the levels recorded as recently as 1983. Furthermore, most of the recent increase in investment had been the result of an increase in public sector, rather than private sector, capital formation.

The flexible and determined fashion in which the authorities had adjusted to changing economic circumstances was commendable, Mr. Suraisry concluded. More generally, Côte d'Ivoire faced a medium- to long-term task of implementing structural reforms in its economy. The World Bank had played and would continue to play a major role in that task. The Fund too could contribute by helping to set up an appropriate environment in which structural adjustment could take place. The good record of the authorities' efforts to adjust their economy deserved all possible support. He supported the proposed decisions.

Mr. Kabbaj said that he was in general agreement with the thrust of the staff appraisal and supported the proposed decisions as well as Côte d'Ivoire's request for a new stand-by arrangement.

The economic and financial performance of Côte d'Ivoire in 1985 had, for the most part, been impressive, with an encouraging 4.9 percent increase in real GDP, a lower inflation rate of about 2 percent, and comfortable external current account and public finance positions, Mr. Kabbaj continued. All performance criteria under the present stand-by arrangement had been met, and financial objectives had been achieved with a large margin. The authorities' cautious fiscal and monetary policies were, however, to be continued in view of the high vulnerability of the economy to exogenous factors, including weather and the fluctuations in world prices of agricultural commodities.

Since 1981 Côte d'Ivoire had implemented consecutive adjustment programs supported by the Fund, Mr. Kabbaj observed. The World Bank had also been providing financial assistance through various structural adjustment loans to help the economy overcome infrastructural constraints, rehabilitate the loss-making public enterprises, and reform the incentive system in the agricultural and industrial sectors. Until 1983 the progress achieved toward restoring financial discipline and reducing external imbalances had been less than programmed because of the adverse impact of exogenous factors, including a further deterioration in the terms of trade and severe drought. In 1984 the continuation of the adjustment program had brought about a substantial reduction in the external current account and public sector deficits, but it had not, however, led to the expected improvement in the economy's output performance.

In 1985, thanks to favorable weather conditions, agricultural output expanded by 8.2 percent, while the growth rate of other sectors, including energy and manufacturing, was offset by a further reduction in the construction industry, Mr. Kabbaj added. That progress improved substantially the economy's financial position. It was also noteworthy that the public sector and external current accounts, which had been programmed to show deficits amounting to 1.5 percent of GDP and 3.1 percent of GDP, respectively, had generated surpluses equivalent to 3.7 percent of GDP and 1 percent of GDP, respectively. That development and appropriate debt relief had enabled the authorities to reduce the public sector's outstanding arrears. The implementation of tight credit policy, together with the substantial improvement in public finance, had decreased the demand for credit to the public sector and had brought about a further decline in net domestic assets and net foreign liabilities of the banking system.

He commended the authorities for the successful implementation of the adjustment program and welcomed the progress recently achieved in many areas, Mr. Kabbaj remarked. However, in view of the vulnerability of the economy to exogenous factors, Côte d'Ivoire still had far to go to keep the economy on track. Thus, the momentum of the adjustment effort should be maintained and structural reform should be continued. The proposed two-year stand-by arrangement, together with the third structural adjustment loan being provided by the World Bank, would financially help the authorities to pursue their prudent program for 1986-87.

Mr. Foot remarked that Côte d'Ivoire had made much progress in recent years and had performed most credibly under the present stand-by arrangement. He was, however, surprised that the Board was being asked to approve outright the proposed stand-by arrangement. It was his understanding that the program would not be fully financed until the Paris

Club had met later in June. He would have expected that the procedure followed with respect to Zaïre would have been more appropriate, in that the Board would have agreed to the arrangement in principle at the present meeting, and the agreement would then have entered into force after the Paris Club meeting had assured that the program was fully financed. He thus questioned the consistency of the practice governing the approval of stand-by arrangements.

With respect to financing the program, he would appreciate staff confirmation that the assumptions made regarding coffee and cocoa export prices for 1986 were consistent with recent developments, Mr. Foot added. Cocoa prices had fallen sharply, and he would appreciate a brief comment on that point.

As to the program, he agreed with those Directors who felt that although much had been accomplished, much more remained to be done, Mr. Foot commented. In particular, the ad hoc nature of the tax system required considerable attention in the coming years. In addition, there was a need to open up the economy. Efforts should also be made to eliminate distortions in the financial system. For example, under the World Bank's third structural adjustment loan, the Government was considering the reduction of the tax on interest rate from 25 percent to 20 percent. That rate indicated a high cost of disintermediation, even after a third structural adjustment loan. He therefore urged the authorities to press ahead quickly with their adjustment measures according to an established timetable.

He agreed with Mr. Goos's remark that the Fund's financial contribution to Côte d'Ivoire's stabilization efforts seemed ideally designed to continue Fund support for the adjustment effort, while at the same time reducing Fund exposure, Mr. Foot remarked. Finally, he supported the proposed decision.

Mr. Fujino noted that the adjustment efforts of the Ivoirien authorities since 1980 to reduce the excessively large deficits in both the external account and the public sector under Fund-supported programs had not, in fact, been very successful at first. Real GDP had remained stagnant, and deficits had remained largely unchanged. Those unsatisfactory results could to a considerable extent be attributed to a series of adverse exogenous developments, including declines in the terms of trade and severe drought. Nonetheless, the adjustment effort, including structural reform, had been continued with determination. The authorities' structural policies had included essential reforms, such as the improvement of the incentive scheme, the rehabilitation of public enterprises to strengthen their performance, and promotion of investment. Those policies had been adequately supported by structural adjustment loans from the World Bank. He was encouraged to note that the authorities' perseverance in their efforts had at last been rewarded following the return of favorable exogenous conditions.

The major objectives of the 1985 program had been achieved, and all performance criteria had been met, Mr. Fujino continued. He highly commended the authorities for those achievements. Their success had demonstrated to the region that comprehensive economic programs, when pursued with perseverance and determination, would yield positive results as the conditions surrounding the economy improved. In 1985 real GDP had increased by a healthy 4.9 percent, and both the public sector and the external accounts had generated surpluses.

The authorities could not afford to be complacent, however, because of the vulnerability of the economy to changing external conditions and because of the heavy external debt burden in coming years, Mr. Fujino considered. In the area of public finance, revenue had increased considerably since 1984. Some of the increase represented basic structural improvements, such as the strong performance of the public enterprises. However, in view of an expected decrease in the surplus of the stabilization funds, it would be important to further strengthen the tax system. He expected that the authorities' intention to broaden the tax base, as expressed in the letter of intent, would fully materialize. On the expenditure side, it was crucial to contain the growth of current expenditure. He understood that the wage increase for civil servants was a one-time adjustment and that strict limitations would apply in coming years. He wondered how the past wage situation had affected the morale of government officials and what future prospects might be.

Looking ahead, the external situation would remain difficult and success would depend on improving the competitiveness of the economy, Mr. Fujino observed. The trade structure of Côte d'Ivoire was favorable, with a low ratio of imports to exports, and supply-side measures would be effective to that extent. In addition, the decision to maintain CFAF 40 billion in reserves at the level of the CAA and the Treasury was a prudent one. The Fund and the World Bank had been instrumental in supporting the authorities' adjustment efforts, and he expected that the authorities would wisely use the leverage provided by the proposed two-year stand-by arrangement. The requested arrangement was fully warranted, and he supported the proposed decision.

Mr. Mtei noted that the adjustment process was continuing in Côte d'Ivoire and that considerable progress had been recorded in the past year. The request for a new stand-by arrangement, which he fully supported, attested to the authorities' commitment to pursue prudent policies and to their desire to work closely with the Fund to find solutions to their economic problems. Côte d'Ivoire had also maintained an amicable relationship with the World Bank, which had been fruitful in helping the country map out a program aimed at the structural reorientation of the economy. That two-pronged approach to economic and financial programming must be encouraged, because experience had shown that policies explicitly aimed at structural change formed the link between financial stability and long-term economic growth.

Two points made by Mr. Alfidja highlighted the nature of the adjustment process in Côte d'Ivoire, Mr. Mtei considered. One was the fragile nature of the progress made so far, considering the uncertainties surrounding the prices of the country's major export commodities and the likelihood of significant downward deviations if some of the assumptions did not hold as indicated by the sensitivity analysis. For example, a 5 percent drop in cocoa and coffee production or prices would, other things being equal, worsen the public sector and external current accounts by 1 percent of GDP and increase the country's financing needs by about CFAF 35-45 billion a year--an amount equivalent to the reserves the authorities intended to maintain. Thus, the important role of the external environment in the adjustment process could not be overemphasized.

The other point was that the accomplishments of the adjustment programs in Côte d'Ivoire had entailed a high cost--namely, an increase in unemployment and a decline in purchasing power in certain parts of the country, Mr. Mtei observed. For that reason, and because of the high rate of population growth, the authorities' emphasis on economic growth should be appreciated and supported with adequate concessional financing, in view of the country's high external debt. Private sector investment could also play a meaningful role in boosting economic growth in the context of the country's liberal investment climate. Finally, he supported the proposed decisions.

Mr. Ercel said that after several difficult years, developments in the Ivoirien economy in 1985 were impressive and encouraging. He commended the authorities for their determined efforts, which had led to those good results.

The new program in support of the proposed two-year stand-by arrangement had been well designed, Mr. Ercel considered. He hoped that, aided by strong collaboration between the Fund and the World Bank, the program would succeed in establishing a viable economic situation in the medium term. In sum, he supported the proposed decision.

Mr. Vasudevan said that he was in general agreement with the staff appraisal and supported the proposed decisions.

While Côte d'Ivoire's performance in 1985 had been impressive, it was largely on account of some fortuitous external factors, Mr. Vasudevan observed. The future financial outlook, especially for debt servicing, was worrisome, mainly because of the low economic diversification, limited export base, and uncertainty about future movements in the terms of trade. In the circumstances, the authorities would have to continue to carefully handle the fiscal and monetary situation and to normalize relations with external creditors.

The adjustment made thus far was also impressive and the comprehensive adjustment program that had been adopted was adequate, Mr. Vasudevan remarked. The support of the World Bank through structural adjustment loans would prove to be helpful. The refinancing agreements recently concluded with commercial banks covering the period 1986-89 would facilitate the closing of the financing gap over the next few years. But the additional financing requirements would be large over the medium term. The staff had indicated that purchases under the proposed two-year standby arrangement would cover much of the financing gap through 1988, but that would depend critically on the outcome of the Paris Club's consideration of the authorities' request for debt rescheduling. Even if the Paris Club's response was favorable, he wondered whether the Fund's financial support had been worked out too finely in relation to closing the financing gap. For example, what would happen if expected additional capital inflows did not materialize as projected over the medium term? He was concerned that outstanding Fund credit, including purchases under the stand-by arrangement, would decline from 336 percent of quota at end-May 1986 to 254 percent at the end of the arrangement. The Fund was familiar with the situation in Côte d'Ivoire, and the country's relations with the Fund had been excellent. Moreover, the progress made by Côte d'Ivoire in recent years had been commendable. Finally, he requested further clarification regarding the period of monitoring sought in the rescheduling negotiations.

The staff representative from the African Department remarked that while the authorities' adjustment efforts had been commendable, the favorable performance in 1985 was to a considerable extent the result of exogenous factors--as had been Côte d'Ivoire's underperformance in the past. It was encouraging that even though the financial situation was much improved in 1985, the authorities had decided to keep to the adjustment path and had been able to build up substantial reserves while reducing both the liabilities on the operations account and the public sector's liability to the banking system, thereby putting the country into a stronger position to deal with any future difficulties.

The staff had taken a relatively conservative position regarding the expected supply response to structural adjustment in view of the many uncertainties facing the economy, the staff representative explained. For example, as a result of the debt crisis and the liquidity crisis, capital and investment expenditure had declined substantially in the recent past. Consequently, few projects were in the pipeline and investments were low; it would take some time before the economy could enter a more expansive phase. The World Bank had supported the supply response through three structural adjustment loans, and in the coming months would be reviewing a new development plan with respect to the quality and scope of investment projects. Nonetheless, it would be unrealistic to expect a rapid supply response from the industrial sector, particularly in view of the high cost structure of Ivoirien industry compared with world markets.

Prospects on the export side were more favorable, the staff representative added. The main thrust of the third World Bank structural adjustment loan was to promote diversification crops, such as palm oil, rubber, pineapples, and bananas. Unfortunately, world prices for those commodities were low. Thus, it would be difficult to achieve substantial export growth through diversification crops in the present circumstances.

The dollar price of Ivoirien commodities had declined recently and, according to the latest world economic outlook forecast, especially the forecast for coffee and cocoa, a further decline in dollar terms was expected.

The general stance of the Government regarding economic development was to give greater room to the private sector, the staff representative observed. The Ivoirien policy was essentially based on market forces and private sector development, and the authorities considered that the extensive movement toward state enterprises in the 1970s had probably been ill advised and it would take some time to reverse. The extent to which the private sector would be able to assume a role and become more growth oriented remained to be seen, particularly in view of the generally unfavorable situation in world commodity markets, but it was hoped that the various incentives being put in place in the context of structural adjustment would encourage the private sector to show greater initiative and interest in expanding production.

The outflow of capital in the past had reflected various factors, the staff representative noted. Because the situation in Côte d'Ivoire had not been very buoyant in recent years, some funds had been shifted abroad, which was possible in the context of the franc area arrangement. However, the Central Bank had recently been pursuing a conscious policy of keeping interest rates in the Monetary Union somewhat higher than those in French financial markets in order to prevent the development of interest differentials and discourage capital flight. In addition, an increased demand for lendable funds in Côte d'Ivoire was expected as production recovered.

A technical assistance mission was holding discussions with the Ivoirien authorities, and details of those discussions were not yet available, the staff representative remarked. The staff had, however, insisted on the need to strengthen revenue performance and tax buoyancy, particularly in view of the likely decline in revenues from the stabilization fund in coming years. Thus the revenue structure needed to be improved, particularly in the context of the 1987 budget. He expected that the mission's report would be studied by the authorities with the intention of implementing some of its recommendations in the context of the 1987 budget.

The strategy for rehabilitating the development banks involved stretching out the Government's contribution as much as possible--given the large amount of the losses--to lessen the impact of the burden, the staff representative commented. The authorities intended to rehabilitate the Agricultural Development Bank as quickly as possible, which would require government disbursements, and those costs had been accounted for in the 1986 program. The first step was to consolidate the large amount of outstanding accidental overdrafts--namely, those overdrafts given by the Central Bank that were not in line with statutory requirements. The Directors of the BCEAO were scheduled to meet on July 1 to consider that question. The issue was important because a high penalty--about 26 percent--was charged on the overdrafts outstanding, which increased the difficulty of making any progress on repayments.

The present prices of coffee and cocoa were somewhat lower than had been assumed at the time the program was put together, the staff representative noted. The impact of lower prices would probably be limited in 1986, because the bulk of the cocoa and coffee crops had already been exported at relatively good prices. The major impact of the cocoa price decline would be felt in the coming crop year, which would begin on September 1, 1986. The crop would be harvested mainly in 1987 and the adverse impact of prices would have to be taken into consideration at the time of the first review in the fall of 1987. Because of the possible impact of lower prices, the forthcoming report of the technical assistance mission on measures to strengthen the revenue base was even more important than had been thought earlier.

The staff considered that four elements were required to cover the financing gap: the financial support of the Fund, the financial support of the World Bank, the multiyear debt rescheduling of commercial banks, and debt relief from the Paris Club, the staff representative commented. Three of those elements had already been obtained. The fourth would be decided in the coming week, and initial indications were that the Paris Club would not object to a rescheduling. The staff therefore felt that outright approval of the stand-by arrangement was warranted. The procedure that was being proposed was similar to that followed a year earlier in a similar situation.

The reduction of tax on interest rates was being effected in the context of the Bank's structural adjustment loan, the staff representative remarked. A timetable had been agreed, and the first decrease in the tax would take place as scheduled. Although the reduction was a gradual one, the tax raised a substantial amount of revenue, and the authorities would have to find other revenue sources as the tax was removed. The tax was mainly a consumer tax; it did not affect industrial development to a significant extent because the productive sectors could deduct the tax from the value-added tax.

Several Directors had commented on the substantial increase in public sector wages in 1986, the staff representative recalled. However, during previous consultations, several Directors had asked how long the Ivoirien authorities could continue a wage policy under which no increases in wages had been granted between 1982 and 1985, and all merit increases had been blocked for a period of several years. Subsequently, the authorities had decided that it was not possible to continue that policy and had lifted the blocking of individual merit increases. The catch-up effect would of course have some impact on wages and services in the future. The authorities recognized that public wages in Côte d'Ivoire were relatively high compared with those in neighboring countries in the franc area and had agreed that there would be no general wage increase in 1986 or 1987. It was also recognized that high wages in the public sector had contributed to the difficult cost-price situation in the industrial sector.

The commercial banks had agreed in principle to grant a four-year debt rescheduling with the understanding that upon the expiration of the two-year stand-by arrangement in June 1988 appropriate monitoring arrangements would be put in place, the staff representative from the African Department explained. The Ivoirien authorities had also asked for a four-year restructuring agreement from the Paris Club. It was possible that the Paris Club would also insist on appropriate monitoring arrangements extending beyond the expiration of the proposed stand-by arrangement with the Fund.

The staff representative from the Exchange and Trade Relations Department recalled that according to the guidelines agreed by Directors in the fall of 1984, the procedure for approval in principle was to be applied only in exceptional circumstances and only if all other methods to secure the closing of the financing gap had been exhausted. In the present instance, both the authorities and the staff had informally consulted with the Côte d'Ivoire's major creditors, and it appeared likely that the rescheduling required would be forthcoming. As in all similar stand-by arrangements, provision had been made to examine the details of the rescheduling arrangements at the time of the mid-term review and to adjust the program as necessary at that time. In the past two and a half years, approval in principle pending the outcome of negotiations with the Paris Club had been rare.

Financial support under the arrangement was equivalent to 30 percent of quota annually in gross terms, and outstanding Fund credit to Côte d'Ivoire would decline from 330 percent of quota to about 250 percent of quota over the period of the arrangement, the staff representative from the Exchange and Trade Relations Department continued. Côte d'Ivoire had made use of Fund resources since 1981, and its outstanding use of Fund credit was among the highest among member countries. In recent years, annual gross access had progressively declined: two years previously, the stand-by arrangement was for an amount equivalent to 50 percent of quota; in 1985 it was equivalent to 40 percent; and under the proposed two-year arrangement it was equivalent to 30 percent. The staff considered that the amount of access was consistent with the criteria governing access, particularly in view of the relatively favorable external environment. Moreover, it was important that some cushion be built into the program to support the authorities' medium-term strategy. Thus, the authorities were building up a reserve fund of CFAF 40 billion in domestic currency at the level of the CAA and the Treasury to guard against unforeseen developments. At the same time, the level of access proposed in the new stand-by arrangement would enable Côte d'Ivoire to reconstitute its potential access to Fund resources, which was desirable in the context of the authorities' medium-term strategy.

Mr. Kabbaj said that the level of access was surprising. The financing gap amounted to $145 million, and net reflows to the Fund were SDR 32 million. Considering the magnitude of the financing gap, he considered it appropriate that at least some Fund exposure should be maintained. He also recalled that Côte d'Ivoire had been mentioned as a suitable candidate for the Baker debt initiative and wondered whether consideration had been given to any new commercial bank financing. If a country that had made good progress with the support of the World Bank and the Fund did not warrant new net inflows from commercial sources, he wondered how other countries mentioned in the Baker initiative, whose problems were more compounded, would find the resources necesary to fill their financing gaps and provide for more growth to enable them to repay their debts.

The staff representative from the African Department acknowledged that under the new arrangement there would be a net flow of resources to the Fund. As to further commercial bank exposure in Côte d'Ivoire, the Ivoirien authorities recognized the difficult external debt situation facing the country and considered that under the circumstances, they would have to be very prudent in taking on further lending on commercial terms that would increase their debt service burden. Their strategy was, to the maximum extent possible, to finance investment expenditure using concessional borrowing from traditional lenders and multilateral lending institutions. Moreover, while commercial banks might be reducing their exposure to the public sector in Côte d'Ivoire, they had indicated on an informal basis that they would be ready to finance appropriate projects in the private sector. Commercial banks had participated in some new financing in conjunction with World Bank lending. The staff expected commercial bank exposure in Côte d'Ivoire to increase slightly in the next few years.

Mr. Kabbaj remarked that there seemed to be some inconsistencies between the central objective of the Baker plan and the staff's view that because a country's debt situation was difficult, it should avoid further commercial lending, especially at a time when the Fund was reducing its own exposure in the country. Commercial bank lending to the private sector to finance shorter-term operations on commercial terms was also not consistent with the Baker plan, under which resources were supposed to support development in order to promote higher growth rates that would enable the country to better service its debts in the medium term.

Ms. Bush observed that whether or not a country had been designated as a potential candidate for the Baker debt initiative, the country would have to decide whether incurring additional debt on commercial terms was consistent with prudent financial management, including management of its debt burden. It was not intended that commercial bank lending should be forced on a country. She was pleased to learn that commercial banks had expressed a willingness to lend to the private sector in Côte d'Ivoire. The Baker debt initiative had not specified a particular kind of lending by commercial banks, and lending to the private sector could promote development and growth and was as important, if not more so, than increased lending to the Government.

The Chairman remarked that the Fund had been active in Côte d'Ivoire, lending more than SDR 550 million over the past year. When Côte d'Ivoire's financial crisis emerged, the Fund had stepped in boldly, had taken a very positive attitude; moreover, its relations with Côte d'Ivoire had been constructive: consequently, the country's external accounts were moving back into a much more favorable position, and it was therefore appropriate for its outstanding use of Fund credit to be reduced over the coming years. The Fund's net contribution to Côte d'Ivoire's financing should be integrated into a better-structured framework that would include concessional finance, long-term finance, and finance from the World Bank and from other donors in the form of contributions and reschedulings. Furthermore, reconstituting Côte d'Ivoire's position in the Fund would give the Ivoirien authorities a greater margin for maneuver in the future.

The Chairman then made the following summing up:

Executive Directors generally concurred with the thrust of the staff appraisal in the report for the 1986 Article IV consultation with Côte d'Ivoire. Directors noted with satisfaction the substantial progress achieved in 1984-85 toward reducing external and internal imbalances and creating conditions for a sustainable economic growth. While noting that the outcome in 1985 partly reflected favorable external developments and climatic conditions, Directors commended the authorities for the intensification of their adjustment efforts during this period.

The Directors emphasized that despite the encouraging progress made, the financial situation of Côte d'Ivoire would remain fragile over the rest of this decade. They noted that the high degree of vulnerability of both the public finances and the external accounts to shifts in world market prices for coffee and cocoa left the authorities with little room for maneuver. In this connection, Directors welcomed the authorities' intention to continue their cautious fiscal and monetary policies, while at the same time giving more emphasis to structural measures aimed at diversifying the economic base and stimulating growth. In particular, they encouraged the authorities' efforts to improve tax collection, implement new revenue measures, and exercise still more caution in wage and hiring policies in the public sector. In the latter context, it was pointed out that average remuneration levels in the Ivoirien public sector are significantly higher than in neighboring countries, under regional standards.

Directors welcomed the progress made to improve further the situation of the public enterprise sector, but stressed that much further progress was needed to strengthen the financial position of those enterprises, and that scope remained for divestment and privatization. Similarly, the authorities were encouraged to pursue the restructuring of certain specialized banks and to improve financial intermediation to raise domestic savings.

Noting the overriding need for Côte d'Ivoire to achieve economic diversification, Directors emphasized the importance of the policy reforms supported by the third structural adjustment loan recently approved by the World Bank, which aims mainly at improving incentives for private sector development in the agricultural and industrial sectors, at reducing distortions, and at strengthening public investment programming. In this connection, several Directors expressed disappointment at the slow pace of supply-side response and at the projected slow growth of nontraditional exports. They stressed the need to encourage competition, to reduce protection of domestic industry, to broaden the tax base, and to reduce reliance on ad hoc exemptions. Directors expressed satisfaction at the close collaboration existing between the World Bank and the Fund.

Directors generally supported the policies described in the financial program for 1986-88. More specifically, they welcomed Côte d'Ivoire's determination to reduce progressively recourse to exceptional financing and to maintain a prudent external borrowing policy, with the objective of re-establishing normal relations with external creditors by the beginning of the next decade. In this respect, they noted the measures being implemented in order to reduce the risk of the external debt strategy arising from external shocks. They noted in particular the buildup of reserves and the Government's intention to meet all interest payments due on government debt as of 1987 from its current reserves. Directors also welcomed the refinancing agreement recently concluded with commercial banks, which covers the four-year period 1986-89, and expressed the hope that official creditors would consider favorably the country's request for debt rescheduling in the context of the Paris Club.

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

The Executive Board then took the following decisions:

1986 Consultation

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

2. The Fund notes with satisfaction that Côte d'Ivoire continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 8311-(86/101), adopted
June 23, 1986

Stand-By Arrangement

1. The Government of Côte d'Ivoire has requested a stand-by arrangement for a period of 24 months from June 23, 1986 to June 22, 1988 in an amount equivalent to SDR 100 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/113, Supplement 2.

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

Decision No. 8312-(86/101), adopted
June 23, 1986

2. CHAD - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Chad (SM/86/117, 5/30/86). They also had before them a report on recent economic developments in Chad (SM/86/125, 6/9/86).

Mr. Alfidja made the following statement:

The performance of the Chadian economy was uneven in 1985. While an impressive rate of growth was recorded in the production sector, financial developments were adversely affected by the sharp drop in the export price of cotton, thereby overshadowing the considerable progress made by the national authorities toward strengthening the administrative institutions and laying the basis for a more sustained growth. In the circumstances, the overall budgetary situation remained difficult and the deficit in the external accounts widened.

In the production sector, thanks to timely and abundant rainfall, food crop production, in particular cereals, rebounded sharply from the depressed level recorded in 1984/85. As a result, real GDP is estimated to have increased by nearly 18 percent in 1985, constituting a large upswing compared with the decrease of nearly 3 percent in 1984. The increase in cereal output was most noticeable for millet and sorghum, which together rose by nearly 30 percent in 1985/86. Groundnut harvests were also bountiful. Cotton, a small direct contributor to GDP but nevertheless the largest source of export earnings and an important source of farmers' income and government revenue, is estimated to have recovered in 1985/86, thanks to better weather conditions. Remunerative prices and adequate supply of fertilizers and insecticides provided significant inducements to increasing output. Livestock, an important contributor to GDP, has not yet recovered from the impact of the drought of the past years. Activity in the manufacturing sector was virtually stagnant in 1985 whereas a small expansion in commerce was registered.

A considerable deceleration in economic activity in 1986 is projected by the staff. In order to carry further the task of reconstruction under way and by the same token reinforce the economic infrastructure and productive base of the country, the Government intends to implement a three-year Development Plan (1986-88). More specifically, this Plan aims at combating soil erosion, improving the water supply, and rehabilitating transport facilities so as to create or upgrade conditions for increased food and livestock production. As reported by the staff, following a UNDP-sponsored Round Table held in Geneva in December 1985, further sectoral meetings have taken place in N'Djamena in order to focus more closely on the priority projects, notably in the agricultural and transportation sectors.

On the whole, the financial position of the Central Government remained under strain in 1985 as in the preceding year, the overall fiscal deficit--on a cash basis--amounting to about CFAF 3 billion or 2 percent of GDP. While revenue rose, government expenditures also increased. The moderate increase in receipts in 1985 reflected the incidence of higher tax rates that were introduced as well as significant improvements in tax administration, as reported by the staff. In particular, the creation of a tax inspection brigade, tax collection centers outside the capital, and tax control files for some large companies contributed to this overall improvement in the tax administration. The generally better performance of the economy in 1985 also played a role in the revenue increase. Expenditure growth was relatively modest in 1985, reflecting essentially a small rise in the wage bill. This drift in wage payments is in line with the Government's policy of national reconciliation and the need to fill critical vacancies at various echelons of the Administration.

The fiscal situation is forecast to continue to be difficult in 1986, largely because of the unfavorable effects on revenue arising from the steep drop in cotton export earnings. For example, the export tax on cotton alone is projected to fall from nearly CFAF 3 billion to less than CFAF 600 million. On the favorable side, the reintroduction in 1985 of the poll tax and taxes on some commodities such as beer and sugar should yield important receipts to the Treasury in 1986. The rise in outlays in 1986 is essentially attributable to the increase from 50 percent to 60 percent in the share of the 1978 salary level paid to civil servants. This adjustment is all the more necessary considering that inflationary pressures prevail in the economy. However, measures aimed at restraining the growth of government spending are also under consideration, including inducement for early retirement and the introduction of competitive examinations for the recruitment of government workers. Expenditure control is also to be reinforced by setting quarterly ceilings on outlays. With the same objective in mind, the Government decided that, effective June 1985, all expenditures are to be channeled through the normal budgetary process.

The performance of the banking sector and monetary developments reflected to a large extent the difficulties associated with the reconstruction of the economy as well as the effect of adverse exogenous factors. As reported by the staff, banking activities continue to be unfavorably influenced by the existence of a large amount of nonperforming loans. This situation has been aggravated by the impact of the unforeseen fall of the export price of cotton. In the view of my authorities, the problem of reimbursement of the loans granted prior to or during the disturbances is complex and will take time to be resolved. In light of the preponderant role of cotton in the economy at large, in particular as a direct and indirect source of income to several economic agents, it is expected that a return of the export price of cotton to more remunerative levels will give an impetus not only to the economy but to banking activities as well. The interplay of such a price movement, together with the cost-cutting measures being implemented by COTONTCHAD, will act to strengthen the cash flow position of this public enterprise and probably ease its recourse to bank credit, which may thus be made available for other uses in the economy.

Developments in the external sector were dominated by the precipitous fall of cotton export earnings and the rise in implicit service outflows on account of oil exploration. Indeed, following three years of surplus culminating in over SDR 16 million in 1984, the overall balance of payments swung into a large deficit of close to SDR 25 million in 1985. A drop in cotton prices by 20 percent, together with a decrease in volume by nearly 40 percent in 1985 owing to the effects of the 1984 drought, led to a more than halving of foreign exchange earnings from cotton exports to less than SDR 46 million. Concomitantly, the current account position has weakened, reflecting also a large debit in the service account owing to increased payments to workers and the leasing of oil equipment.

On the basis of staff projections, the external outlook for 1986 is not bright because of expectations of an ever larger decrease in cotton export prices to a five-year record low of CFAF 390 per kilo, representing a further drop by 35 percent. Altogether, the price of the main source of foreign exchange and income for a large segment of the Chadian population would have plummeted by 55 percent over a two-year period. As a result, the terms of trade of Chad are to fall cumulatively by nearly 60 percent over this two-year time span. Understandably, such prospects are of grave concern to my Chadian authorities. In reaction to this crisis, the Government of Chad has promptly taken measures which in time should lead to a reduction in the costs of COTONTCHAD and thereby improve its financial situation. These measures, which are detailed in the staff report, involve the streamlining of marketing networks, the reduction of the transportation fleet, cutbacks in personnel, and a wage freeze.

To conclude, the predicament arising from the drop in the export price of cotton is clearly not of Chad's making. However, the Chadian authorities have responded decisively by taking actions toward reducing the impact of this development. They hope that the international financial community, including the Fund will provide to their country timely and sufficient assistance in order to help them bring to fruition their efforts to rebuild the economy.

Extending his remarks, Mr. Alfidja noted that the staff had urged the elimination of external payments arrears, and his authorities wished to reaffirm their unwaivering commitment to clear all interest payment arrears in an orderly fashion. Failure to reach agreement with the Fund on an economic and financial program aimed at eliminating other arrears should not be construed as a lack of concern about the problem. Instead, it reflected a number of considerations, particularly the bunching of amortization payments within too short a period of time and the need to establish, first, the legitimacy of claims and then a realistic timetable for their elimination. The staff had given a detailed description of the financial difficulties facing Chad, and the tightness of the fiscal position clearly obviated the possibility that Chad would be able to clear payments arrears expeditiously. The virtual breakdown of proper budgeting procedures during the period of civil disturbance had resulted in unauthorized expenditures, some of which were being presented to the Treasury for settlement. In many instances there was no evidence of the delivery of goods and services charged to governmental institutions. In sum, the authorities were intent on eliminating payments arrears once the legitimacy of the claims had been documented.

Subsequent to the Fund mission, the authorities had taken a number of measures, which were listed in Appendix XIII to the report on recent economic developments, to deal with some of the issues raised in the staff appraisal, Mr. Alfidja observed. As the authorities had indicated to the staff, while they understood the rationale behind some of its suggestions, they considered that Chad's particular situation called for flexibility and consideration. For example, to improve fiscal performance, the staff had suggested that no increase should be permitted in the civil service, that the burden of military outlays on the budget should be reduced, that the taxation of petroleum imports should be increased, and that the surcharge on salaries should be reintroduced.

As to limiting the increase in the civil service, in addition to the need to keep wage increases for civil servants in line with available resources, the authorities had to consider the need to rebuild Chad's Administration after years of civil disturbance and economic disruption, Mr. Alfidja remarked. Although some progress had been made, more needed to be done. Moreover, recommendations in that area also had to take into consideration the policy of national reconciliation. While progress had also been made in that area, it represented a delicate aspect of the problem, which required both understanding and flexibility.

The authorities had clearly stated their desire to reduce the burden of military outlays on the budget, Mr. Alfidja continued. Unfortunately, the resumption of hostilities owing to the occupation of a part of the country might give rise to some unforeseen expenditures. That was not to say that the authorities were not aware of the meagerness of the domestic resources available to deal with the situation.

As to increasing the tax on petroleum imports, the staff had pointed out that a large informal market in petroleum products from Nigeria and Cameroon had undercut official prices, Mr. Alfidja recalled. It was important to understand the functioning of the informal and official markets before reaching a decision on the taxation of petroleum products.

With respect to reintroducing a surcharge on salaries to finance part of the salary increase granted to civil servants in 1986, Mr. Alfidja remarked that his authorities had asked him to remind the Executive Board and the staff that for several years civil servants had been paid 50 percent of their official salary. Wages had recently been increased to 60 percent. The restitution of salaries took into consideration the political situation in Chad, where even the Ministers did not have cars. There was a limit to wage restraint, and wage policy had to be realistic.

In sum, the considerations he had mentioned had to be taken into account if an adjustment program for Chad was to be agreed with the Fund, Mr. Alfidja concluded.

Mrs. Ploix remarked that the authorities were to be commended for the results achieved so far: the country was back to work, the administration had been reorganized, and production had started to increase. Nonetheless, Chad was still facing a critical situation. The current account deficit was projected to widen in 1986 largely because of the shortfall in world cotton prices. The present difficulties derived to a large extent from factors beyond the authorities' control. But the staff was right in stressing that other factors could be addressed by the authorities, in particular, the control of expenditures, a wage and benefits policy compatible with the maintenance of a sound financial equilibrium, and firm demand management policies.

Economic adjustment implied a determined effort and dedication on the part of the authorities, especially on the fiscal front, Mrs. Ploix continued. She was in general agreement with the staff regarding the adjustment policies needed. Three issues appeared to be of particular importance: resolving the problem of COTONTCHAD, bringing down the public sector deficit, and addressing the problem of arrears.

The problem of COTONTCHAD could no longer be handled solely by the authorities, Mrs. Ploix remarked. The World Bank was at present discussing the extension of a $15 million credit to support the first emergency phase of a program aimed at re-establishing COTONTCHAD on a sound financial basis and avoiding the collapse of Chad's dominant productive sector as a result of exceptionally low world cotton prices. In past years, the cotton sector had accounted for 80 percent of export earnings and 25 percent of government revenue, and nearly 650,000 people were actively engaged in cotton production. It was therefore crucial to maintain that activity as there was clearly no foreseeable substitute for it in the medium term. Under the emergency program, the authorities had agreed to implement a set of energetic and courageous measures to drastically reduce production costs, including extensive layoffs of personnel, the closing down of plants, and a phased elimination of import subsidies to producers. The comprehensive program, which amounted to $47 million, was cofinanced by several donors, including the French authorities, who strongly believed that a substantial part of the Chadian economy would be reformed through the rehabilitation of that sector, thereby allowing Chad to pursue its comprehensive adjustment efforts.

The task already accomplished with respect to public finances--namely, tackling the imbalances, increasing fiscal revenues, and improving tax administration and collection--was commendable, Mrs. Ploix remarked. Fiscal adjustment thus far had focused on revenue and had exceeded the target expected in September 1985 by CFAF 2.8 billion. However, expenditures had increased more than had been projected. The authorities needed to adopt a policy aimed at restoring the control of public expenditures, including the integration in the budget of operations financed at present on extrabudgetary funds.

The accumulation of arrears, both internal and external, was regrettable, Mrs. Ploix observed. She encouraged the authorities to accelerate their efforts to identify the status of those arrears so as to implement a plan for their elimination. She agreed with the staff that in order to avoid the accumulation of new arrears together with additional external financing, further adjustment measures were needed to reduce the deficit. Mr. Alfidja's comments in that regard were most welcome.

Of the reforms to be implemented, control of public finances and restoration of a viable financial position must be given the highest priority, Mrs. Ploix remarked. She agreed that adjustment was crucial in the present circumstances but recognized that Chad was among the poorest countries in the world and badly needed concessional flows. That need had been clearly recognized at various donors' meetings. The Fund was also actively providing assistance through a drawing on its compensatory financing facility approved in September 1985. Chad might also be eligible for the use of resources of the structural adjustment facility, if the main imbalances in the economy could be corrected. In the future, the position of other contributors toward Chad, including the World Bank, would be influenced by the authorities' commitment to adjustment and its effective implementation. At present, in order for the process of reconstruction, adjustment, and growth to be efficiently undertaken, a strict discipline in financial and monetary matters was necessary, as were concessional flows.

In sum, the task accomplished so far had been impressive, Mrs. Ploix added. The authorities were to be commended for having successfully tackled a number of difficult problems simultaneously. However, in view of the challenges they were facing, there was no other alternative than to pursue their adjustment efforts. In that regard, France stood ready to provide both encouragement and support.

Ms. Lundsager observed that developments in 1985 had been surprisingly mixed. Although there had been a strong recovery of real economic activity, including, importantly, higher levels of food crop production, a decline in world cotton prices had largely offset the financial benefits of the economic recovery. The outlook was gloomy because the production costs for Chadian cotton exceeded the world market price by a rather wide margin. Since cotton-related fiscal revenues were crucial to budgetary health, it appeared unlikely that the present budgetary crisis would be easily resolved.

Decisive actions were required to bring the situation under control, Ms. Lundsager continued. Such actions were important not only to minimize the growing financial imbalances, but also to demonstrate to donors that the authorities were determined to address the situation with the requisite adjustment measures. Several areas for action came readily to mind. Extrabudgetary spending must be brought under control, including spending at the provincial level. She understood that instructions had been sent to the provinces regarding expenditure control, and the authorities must remain firm in limiting appropriations. The Central Government must itself take the lead in that area by setting spending priorities in line with financing constraints. Significant progress had been made in improving administrative capabilities, but in view of recent expenditure overruns, additional measures were needed. Moreover, civil service recruitment and wages would have to be restrained. While it was understandable that the authorities wished to encourage the return of former civil servants living abroad, incentives to encourage private sector activities might be considered as an alternative to guaranteed employment by the Government. That approach did not seem to be unrealistic since Chadians working abroad were probably engaged in the private sector. Additional efforts were also needed to improve the financial position of the public enterprises. Perhaps some measure of privatization could be meshed with incentives to encourage the repatriation of capital.

Monetary policy was becoming increasingly complicated, with the domestic banking system vulnerable because of nonperforming loans, Ms. Lundsager remarked. Furthermore, the Bank of Central African States (BEAC) might be facing difficulties in view of the adverse impact of the recent oil price decline on the external position of some BEAC member countries and the interdependence of their foreign exchange reserve positions. It was therefore unlikely that the domestic banking system would be able to provide significant levels of credit to the Government. For that reason, and because the Government had some access to official foreign assistance, she urged the authorities to consider providing some measure of credit to the private sector.

The banking system's difficulties might be alleviated through the resolution of the problems of COTONTCHAD, Ms. Lundsager suggested. She would be interested in any further information on progress by the World Bank and donors in formulating an acceptable strategy for addressing that problem. It was difficult to reconcile the extremes of the situation: cotton was vital to the export base of the economy, yet cotton production in Chad was at present far from being competitive on world markets. Clearly, steps should be taken to encourage economic diversification. It was difficult to suggest what those steps might be, since exchange rate changes were unlikely at present and the Government had limited resources available for investment or for providing tax incentives to stimulate private investment. She urged that any controls or regulations inhibiting private sector activity be completely eliminated and that the production of food crops for both domestic consumption and export be encouraged.

Even with Chad's comparatively low level of external debt, budgetary difficulties would complicate efforts to become current on debt servicing obligations, and the medium-term outlook was bleak, Ms. Lundsager commented. Bilateral donors, the Fund, and the World Bank were prepared to assist the authorities in their efforts to address seemingly insurmountable difficulties. The authorities should persevere and move quickly to implement difficult measures. Such determined action would encourage external assistance, including possibly some assistance on the arrears problem. She welcomed the steps outlined in the staff appraisal, which could lay the basis for a comprehensive adjustment program under the structural adjustment facility. She urged the authorities to begin immediately to implement those suggested measures.

The staff representative from the African Department stated that the staff recognized that the elimination of arrears was a difficult problem. As Mr. Alfidja had pointed out, some arrears dating from the period of the civil disturbances were not properly documented, and the authorities were attempting to confirm those arrears with a view to clearing them.

The staff considered, however, that at present the authorities needed to ensure that no new arrears were accumulated and that arrears accumulated since the period of disturbances be settled as soon as possible.

The problem of fiscal adjustment also underscored Chad's difficult situation, the staff representative from the African Department continued. The country had one of the smallest civil services in relation to population in the CFA franc area and also the lowest average salary per civil servant in that area. The Government had been extremely frugal in its expenditures, and of course military expenditures were difficult to control. Nonetheless, the financing gap of the public sector was likely to increase in the coming years, and thus, despite the difficult circumstances, the staff felt that it was important that an effort be made to ensure that expenditures did not increase.

The staff representative from the World Bank reported that the Executive Board of the Bank had approvd the cotton project for Chad earlier that morning. In view of the importance of the cotton sector to the economy he wished to make a few observations. First, before the collapse of cotton prices and before the outbreak of civil disturbances, Chad was not an inefficient cotton producer by African standards. Indeed, its average production costs were in line with countries having similar climatic conditions and cotton production was quite profitable. COTONTCHAD had performed well during the war despite the very difficult conditions with respect to collecting and marketing the cotton crop. However, the situation had surely deteriorated, particularly in the past two years, when the price of cotton had fallen by more than 40 percent.

World Bank assistance would be provided in two phases, the staff representative explained. The first phase emphasized the reduction of costs, particularly through the distribution of improved inputs, the closing down of ginneries and the firing of redundant personnel, the imposition of greater financial controls and improved auditing, and technical assistance. The program was an emergency program in the sense that it addressed the most urgent issues and was designed to be disbursed as quickly as possible.

An important part of the program was Chad's commitment to place a ceiling on acreage in production until the results of the measures mentioned could be observed and the trends in world prices were established, the staff representative from the World Bank remarked. The program would then be extended to include rehabilitation and development, and would incorporate renewed studies of the possibilities of diversification. The opportunities for diversification must be identified and examined so that Chad's dependence on cotton could be reduced. In the meantime, the Bank would work with the authorities to implement the cotton project quickly and efficiently.

The Chairman then made the following summing up:

Executive Directors noted the considerable progress made by Chad over recent years in recovering from the combined effects of prolonged drought and civil unrest in the 1979-82 period. Nevertheless, the persistence and magnitude of financial disequilibria remain a soure of condiserable concern.

In the view of Directors, the most urgent single task was to overcome the current crisis in the cotton sector, which threatens the viability of much of the economy. The recent fall in world cotton prices has hit Chad particularly hard. Directors welcomed the cost-reducing measures being taken by the Chadian authorities in connection with the operations of COTONTCHAD as well as the World Bank's and the donors' emergency rehabilitation program for cotton production, for which there is, for the time being, no realistic substitute.

Directors noted that in recent years fiscal revenues had increased and expenditure controls had been improved. However, expenditure had continued to exceed targets, especially extra-budgetary spending. Directors urged the authorities to introduce new revenue measures to strengthen public finances and improve expenditure control, and to restrain the wage bill. They also stressed that further restraint would be necessary if the external financing requirements of the budget were not to become excessive in the medium term. Directors regretted that new arrears, both internal and external, had arisen in 1985. They urged the authorities to hasten the identification of past arrears and to formulate a plan for eliminating arrears. They also called for the adoption of mesures to improve budgetary procedures in order to cope with this problem in the near future.

With the collapse of cotton revenues, Chad's balance of payments position will be difficult for some years. In view of the extremely tight domestic resource position, both now and in the future, external assistance should be in a form that will not further burden public finances and the balance of payments. Directors urged the pursuit of a tight credit policy, and the adoption of measures to strengthen the banking system and reduce the large volume of nonperforming credit in the economy.

Directors called on the staff to pursue discussions with the authorities and the World Bank on suitable structural adjustment and macroeconomic policies.

Finally, Directors agreed that the next Article IV consultation with Chad should 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 Chad, in the light of the 1986 Article IV consultation with Chad conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Chad continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions other than the restrictions on tourism and business travel allowances as described in SM/86/125.

Decision No. 8313-(86/101), adopted
June 23, 1986

3. ARGENTINA - STAND-BY ARRANGEMENT - REQUEST FOR WAIVER OF PERFORMANCE CRITERIA

The Executive Directors considered a staff paper on a request from Argentina for a waiver of performance criteria under the 15-month stand-by arrangement approved on December 28, 1984 (EBS/86/131, 6/18/86).

Mr. Nebbia made the following statement:

On behalf of my authorities I would like to thank the members of the Executive Board for including in today's agenda the discussion of the request for waiver under the stand-by arrangement with Argentina.

Over the past twelve months there has been considerable progress in addressing the country's economic problems, confidence in the economy appears to have been restored, inflation has been reduced--although not to the extent that has been hoped for--and the level of economic activity is growing. These results are, in the view of my authorities, more than satisfactory. Inflation, as measured by the consumer index, declined sharply from a monthly average of 28 1/2 percent in the second quarter of 1985 to about 2 1/2 percent in the period August 1985-February 1986. This slowdown of inflation was achieved without a decline in output. On the contrary, the negative trend of economic activity that had been observed since the fourth quarter of 1984 was reversed in August 1985 and industrial output is estimated to have recovered by 20 percent from the low level registered in the third quarter of 1985. My authorities believe that the recent acceleration of inflation in the period March-May 1986 to 3 1/2 percent, as measured by the combined index, which resulted mainly from adjustments in key prices like the exchange rate, public tariffs and wages, and from the phasing out of the price freeze, will be reversed in the coming months, and their objective remains to keep a lower rate of inflation for the remainder of 1986.

The combined public sector deficit has been reduced from 12 1/2 percent of GDP in the first half of 1985 to 4.4 percent of GDP in the first quarter of 1986. As a consequence of the freeze during the second half of 1985, real wages in the public sector have declined substantially. The public sector labor force is being reduced by the current policy that consists in not filling the vacancies arising from retirements or resignations. The number of public employees declined by 15,000 from June 1985 to April 1986.

In the first quarter of 1986 there was an overexpansion of rediscounts, and monetary growth was faster than had been planned. The Government will pursue all the necessary measures to reduce money growth in a manner consistent with the inflation target for 1986. The Government has recently increased the regulated interest rates in order to continue to fulfill the commitment to avoid negative real deposit rates and ensure moderately positive lending rates. It is worth highlighting that while the free interest rates have declined to levels very close to those in the regulated market, the spread between the official and parallel exchange rates has been declining systematically during the last four months about 1/2 percent in the past week.

The new program has strengthened Argentina's external position. In the second half of 1985 and the first quarter of 1986, both the current and capital accounts were substantially stronger than programmed. Due to the depreciation of the U.S. dollar against other major currencies the real effective value of the austral has appreciated very slightly, despite it being fixed in terms of the dollar from June 1985 to March 1986. Since April there have been small and frequent adjustments in the exchange rate to compensate for the difference between internal and external inflation.

The performance of the economy in the final period of the program, with respect to its quantitative performance criteria, has been summarized on Table 1 of the staff paper. An important number of criteria have been observed with some margin; nevertheless, some others were not met, despite the efforts made.

My authorities would like to emphasize to the Board that the noncompliance with these performance criteria does not have to be interpreted as the result of a relaxation in their determination to the attainment of the goals set forth in the program, to which they are firmly committed.

In the first quarter of 1986 the limit on the central bank net domestic assets was exceeded and monetary growth was faster than had been planned, due to a number of problems that had made the managing of money and credit difficult. It should be stressed that the demand for money has accommodated through the money supply growth, and the money supply growth can be explained mainly by the overperformance in the external sector accounts.

The staff emphasizes that a rate of growth such as the one registered in broad money aggregates during the first month of 1986 would be inconsistent with the targeted rate of inflation; while agreeing that its influence cannot be overlooked, an indicator that has been used in the past to evaluate the performance in this area has been the spread in the parallel exchange market which has fluctuated around 2 percent during the last week. My authorities have nevertheless agreed on reducing the rate of growth of the monetary aggregates on which I will give more details later.

While it had been the intention of the Government to limit strictly the growth of rediscounts, they expanded by large amounts. To a certain extent the expansion of rediscounts has reflected pressures associated with operations of provincial banks, on which the staff has given due explanations in the footnote on page 6 of document EBS/86/131. I would add that at the same time the Central Bank has taken steps to ensure the future performance of those provincial banks that it has financially assisted.

As regards the fiscal deficit, the authorities' position is that--measured on the basis of changes in net credit from the banking system and net external borrowing by the public sector (and excluding changes in floating debt which had not been included in the definition of the deficit because of the lack of precise data)--the sublimit on the cash deficit of the nonfinancial public sector was met while the limit on the combined deficit was exceeded by a modest amount.

Arrears pertaining to the private sector were eliminated by the end of March 1986 in compliance with the understanding. At the time there were still public sector arrears for US$600 million over and above the limit set on the occasion of the second review. My authorities are very concerned about the failure to reduce those arrears and therefore a survey was ordered on this matter, following which a plan was developed to eliminate them. I am in a position to inform this Board that the Government will settle forthwith those arrears with the Paris Club that have been reconciled, thus lowering the total amount due.

Regarding policy intentions for the remainder of 1986, my Argentine authorities are fully committed to consolidate the stabilization efforts initiated in June 1985. An important objective for 1986 is to keep the average rate of inflation to no more than 2 percent a month.

It is also the intention of my authorities to implement structural measures in order to consolidate the economic recovery that has been under way since the end of last year.

In order to achieve this further reduction in inflation, the authorities are committed to implement prudent fiscal, monetary, and wage policies.

On fiscal policy, the Government plans to keep the combined deficit of the nonfinancial public sector and the Central Bank to no more than 3 percent of GDP in the second half of 1986. The authorities agree with the staff that this decline in the fiscal deficit wll require a reduction in the expenditure by the State Oil Company (YPF), some increase in real terms in the price of public sector goods, a prudent wage policy, the implementation of additional revenue measures as well as a careful management of budgetary commitments. In connection with YPF, it is important to stress the efforts being made by the authorities to improve its financial position. In particular, during 1986 capital expenditures are budgeted to decline by 21 percent, a stricter control on expenditures has already been implemented and current data show that actual expenditures are meeting the targets.

Regarding monetary policy, the authorities plan to bring the average monthly growth of M 5 to 3 percent, in order to ensure the consistency of the stabilization program. The Central Bank will not introduce new rediscount lines and the authorities will take the necessary actions to implement a credible credit program.

The Government will implement wage policy with the objective to ensure the attainment of price stability. By the end of 1986, the authorities will cease to decree economy-wide wage adjustments and they intend to reinstate a system of collective wage bargaining for the private sector.

On price policy, the price freeze has been replaced last month by a system of administrative prices, under which firms are allowed to raise prices when justified by authorized increases in costs, but it is the intention of the Government to move in the near future to a situation in which all prices are determined in the market.

Exchange rate policy will be implemented in 1986 in a flexible way in order to maintain the external competitiveness of the country, and the authorities will keep the adequacy of the exchange rate under review. Also, the authorities have initiated discussions with foreign bank creditors related to the restructuring of 1986 maturities and they expressed to the Paris Club Secretariat their intention to refinance 1986 principal and interest maturities.

Unfortunately, the combination of crop failures and further declines in the prices of Argentine's main export commodities have negatively affected the balance of payments prospects. My authorities want to emphasize that an adequate external environment is a crucial requirement to support our stabilization efforts.

Regarding the transfer of imports to the automatic list, my authorities attached great importance to the implementation of this measure and they are confident that as soon as the study of a possible reform of the tariff schedule to complement this liberalization is finished, this transfer will take place. Some of this work is expected to be carried out in the context of a trade policy and other loans from the World Bank.

Finally, my authorities would like to ask the support of the Board on this request for a waiver for the nonobservance of certain performance criteria of the final period of the stand-by arrangement. The approval of the proposed decision will have a positive effect in the relation with commercial banks and will certainly improve the confidence in the economic stabilization program.

Extending his remarks, Mr. Nebbia reiterated his authorities' firm commitment to clear arrears as quickly as possible. As he had previously mentioned, arrears due to the Paris Club that had been reconciled would be paid immediately. To further demonstrate their commitment to clearing arrears, however, his authorities were examining the legal regulations governing payments with a view to making a payment before a bilateral agreement had been reached, or at least before the figures had been finalized. Pending that legal clarification, his authorities were ready to make immediate payments of approximately $200 million.

Mr. Kafka said that his chair strongly supported the proposed decision. His chair had long insisted that the stand-by arrangement with Argentina had far too many performance criteria, as did many other Fund arrangements. The staff had rightly placed less emphasis on those criteria than on the general thrust of Argentina's remarkable achievements under the program and its policy decisions for the remainder of 1986.

The important aspect, which both the staff and Mr. Nebbia had correctly stressed, was that within a year after the monetary reform, Argentina had witnessed a substantial recovery of industrial production, Mr. Kafka remarked. Certainly, the rate of inflation had been higher than desired, but it had apparently stopped rising despite crop failures and the achievement of the largest and most difficult part of the transition from full price, exchange rate, and wage freezes to considerable liberalization in all those areas.

Nevertheless, the Argentine authorities were right to propose the strengthening of fiscal and monetary policies for the second half of 1986, Mr. Kafka added. A difficult path would have to be negotiated between excessive restriction and excessive looseness. It was impossible to know whether the key targets--namely, those for M5 growth and for the combined deficit of the nonfinancial public sector and the Central Bank--were correct. In an economy with a large public enterprise sector, any particular deficit might simply represent a sensible choice of investment financing policy; to demand a zero deficit or a surplus could be just as inappropriate as to say that no private corporation should ever finance its investments by borrowing but should pay for them exclusively out of equity issues or retained earnings, or even that corporations should at all times repay debt. Moreover, if the public's expectations regarding monetary stability improved, the 3 percent expansion of M5 foreseen for 1986 might prove inadequate. Allowing interest rates to reflect market forces would better enable the authorities to judge whether the rate of monetary expansion was appropriate in the context of Argentina's situation and policy stance. It was encouraging that the authorities had moved in that direction.

He welcomed the authorities' intention to settle public sector arrears and the accomplishment of the elimination of private sector arrears, Mr. Kafka remarked. The removal of exchange restrictions should be allowed to proceed to the extent feasible.

Mr. Dallara remarked that there had been further slippages in the program and that the request for a waiver under the stand-by arrangement with Argentina had to be considered in its overall context. For example, he recognized that the difficulties faced at the inception of the program had been formidable; that the authorities had dramatically strengthened the program with the "shock treatment" introduced in June 1985; and that, slippages notwithstanding, they had taken or had committed themselves to important measures to bring the program back on track. As Directors had remarked at the time of the previous review (EBM/86/43, 3/10/86), considerable economic adjustment had been achieved since the strengthening of the program in the summer of 1985, with industrial production continuing to recover, inflation at a fraction of its former rate, the budget deficit much reduced, and the balance of payments stronger than expected. However, it was somewhat disappointing that the slippages and weaknesses that had been noted earlier still continued.

The program consisted essentially of three mutually supportive elements: an initial wage-price freeze, fiscal and monetary restraint, and some structural reform, Mr. Dallara continued. Price decontrol had taken a step forward in the previous month, but complete dismantling of wage and price controls had proven difficult, perhaps more so than had been initially envisaged. There had been some slippage in fiscal and monetary policy, but new measures should noticeably strengthen financial restraint. Some progress had been made on structural reforms, but continued difficulties in exercising financial restraint tended to confirm the existence of a number of underlying structural problems, which he hoped would be addressed comprehensively and forcefully under a new stand-by arrangement, with the Fund working in close collaboration with the World Bank.

Some weaknesses in the fiscal area had appeared in recent months, particularly the overshooting of the limits on the combined nonfinancial public sector deficit, Mr. Dallara commented. The rise in the ratio of cash expenditures to GDP over the past year was unfortunate and revealed continued difficulties in controlling expenditures, especially by public enterprises. Some expenditure problems were related to underlying structural problems that would have to be redressed if fiscal management was to be more effective in the future. Moreover, the reliance on nonrecurring revenue measures--although understandable in the early phase of the program--could not be sustained over longer periods. However, the fiscal deficit ceiling of 3 percent of GDP that had been established for the second half of 1986 would result in a 3 1/2 percent deficit ratio for the calendar year, which would represent an impressive reversal of recent slippages. Particularly important were the anticipated large cutbacks in spending by the YPF, the planned average increase in the real prices of public sector goods of 7 1/2 percent between June and December, the limits placed on public sector wages in the last half of the year in line with the projected rate of inflation, and a similar commitment to limit social security benefit increases later in the year to the projected rate of inflation. In each of those areas, strenuous implementation efforts would be required if the 3 percent deficit limit was to be achieved.

Greater fiscal restraint should also contribute to a tighter monetary stance, since insufficient control over public spending had been a major element in the more rapid than expected increase in money and credit growth, Mr. Dallara observed. For example, the rate of increase of M5, which had averaged 7 percent between August 1985 and April 1986, was not consistent with the inflation objective of 2 percent a month in 1986. The planned reduction in the rate of growth of M5 of 3 percent a month would be an important constraint during the second half of 1986 and would provide for a substantial deceleration of inflation. He also welcomed the renewed commitment to avoid negative real interest rates on regulated deposits and the recent increase in such rates. At the same time, he hoped that the recent pattern of growth of rediscounting by the Central Bank and the Bank's difficulties in collecting interest on its rediscounts would be improved in the remainder of 1986 as a result of the Bank's commitment not to extend rediscount lines nor to increase existing ones. He attached considerable importance to that commitment.

The dismantling of wage and price controls was proving difficult, Mr. Dallara noted. Although the generalized price freeze had been terminated in May, it was regrettable that 50 mass consumption goods remained subject to ceilings and that large companies needed to obtain prior approval of price increases. However, recognizing that the process was a difficult one, the partial elimination of price controls was welcome, as was the commitment to administer remaining controls flexibly and to allow prices to be determined more fully by the market in the near future. Wage pressures in 1986 had been strong and were growing, especially in the public sector. However, real wages had recovered to their mid-1985 level, which should make it easier for the authorities to resist further upward pressures on real wages. He looked forward to the return of collective bargaining after the end of 1986. Nonetheless, firm implementation of fiscal and monetary restraint would be necessary for prices and wage decontrol to be successfully completed and, indeed, for price and wage pressures to be contained in the interim.

Some developments in the external accounts that had given rise to concern should be alleviated by new commitments by the Government, Mr. Dallara remarked. The exchange rate had appreciated somewhat in real effective terms since mid-1985. External arrears had not been eliminated on schedule--a matter of concern to the authorities--despite the stronger balance of payments performance than originally envisaged. And, while recent commitments to the liberalization of exchange and trade restrictions were welcome, he regretted that that liberalization had been delayed. However, the appreciation of the austral had not been large, and the authorities would keep the exchange rate under review. Arrears were expected to be eliminated in the coming few months. He urged the authorities to move ahead as soon as possible on their new commitment to eliminate exchange restrictions. Unfortunately, there would be further delays in liberalizing import licensing, which was regrettable. The suggestion that part of the reason for noncompliance with that particular performance criterion was the negotiation of a trade liberalization commitment in connection with a World Bank loan was troubling. He understood that complex relationships were involved, but commitment to the Fund clearly existed. He would be interested to hear staff comment on Fund-Bank coordination in that area. In that regard, he recognized that it was important that the study of the reform of the customs tariff schedule be completed and that tariff reform play a part in overall trade policy.

As he had stated at the time of the previous review, it was essential that the structural component of the comprehensive economic program for Argentina be given high priority and prompt attention, Mr. Dallara stressed. The battle against inflation through the pursuit of prudent financial policies was clearly not over, especially in light of some of the slippages that had occurred earlier in the year. Nevertheless, sustainable economic growth and a lower rate of inflation would also depend upon implementing a number of structural reforms. Specifically, better mechanisms for public expenditure control, including spending by public enterprises, must be achieved if longer-term fiscal goals, structural goals, and even the underlying objective of economic growth were to be achieved. He understood that the authorities were planning to privatize some enterprises, which might well be desirable. A more dependable revenue base was needed, including the implementation of the land tax and perhaps other tax reforms. He understood that discussions had been held with the World Bank on tax reform, and he would be interested to hear the staff's views and those of Mr. Nebbia on that matter. During the previous review, it was reported that the authorities were contemplating a "major reform" of the financial system: he invited further elaboration on that important subject. He encouraged the continued use of debt/equity swaps as a means of reducing the burden of foreign debt, while benefiting from foreign equity investment. Such operations would, of course, have to be carefully integrated into the authorities' overall money and credit policies. It might also be worthwhile to conduct a thorough examination of the regime for foreign direct investment.

The task of finding answers to the array of structural problems confronting Argentina was not an easy one, Mr. Dallara commented. However, he firmly believed that in preparing for the negotiation of a new stand-by arrangement, the staffs of the Fund and of the World Bank should work closely in support of Argentine efforts to address some of those reforms, particularly after the results of the renewed efforts to combat inflation had become clearer.

Although some of his comments were critical of recent performance, he did not underestimate the difficulties nor question the authorities' determination to persevere in their adjustment and reform effort, Mr. Dallara stated. At the present stage, it was important that the momentum not be lost and that confidence in the financial community be preserved. Thus, the authorities needed to act strongly to implement the recent corrective policies and policy commitments in order to establish a pattern of success in the fiscal and monetary areas. He believed that the authorities had continued, on the whole, to demonstrate their determination to persevere in that effort. He therefore supported the request for a waiver under the stand-by arrangement. He expected that the authorities and the Fund staff would move promptly toward further discussions to formulate a new, strengthened, and comprehensive program.

Finally, he questioned the linkage between Fund purchases and disbursements under related commercial bank financing arrangements, Mr. Dallara remarked. He had the impression that in the present instance, the commercial banks' insistence on a tight linkage between their disbursements and Fund disbursements might not be in the interest of the bankers or the debtor. He hoped that the Fund staff could look into that matter.

Mr. Goos stated that he had mixed feelings regarding the request for a waiver. He understood that Board approval of requests for waivers was usually granted only if there were minor program slippages that could be corrected and if there was reasonable assurance that the program could be brought on track in due course. Those conditions were not purely academic. Rather, they had been established to give program countries an incentive to pursue consistent and steady adjustment policies that offered the only avenue to eventual success while at the same time ensuring the proper use of the Fund's resources and the effectiveness of its programs. In view of the importance of the latter aspect of the Fund's role in inspiring confidence in other creditors and hence ultimately for its catalytic role, the implementation of the Fund's waiver policy lay at the heart of its ability to effectively discharge its mandate.

Under the present stand-by arrangement, the authorities had made important and impressive strides in the stabilization of the Argentine economy, most notably on the inflation front, and in reducing fiscal and external imbalances, particularly when compared with the situation prevailing in mid-1985, Mr. Goos noted. Those achievements could hardly distract from the extremely worrisome history of the program, which had been characterized by repeated slippages and delayed reviews that necessitated two extensions of the program period, nor could they be excused if they meant the widespread failure to meet performance criteria in the final program period. It was particularly worrisome that the nonobservance of those criteria was reflected in the resurgence of inflationary pressures and corresponding changes in the external accounts, and, equally important, the continued sluggishness of private investment. In that regard, he was less assured than Mr. Nebbia that confidence in the economy had already been restored.

Overall, it appeared that actual performance was considerably short of expectations, Mr. Goos continued. Moreover, the recent return to frequent wage adjustments accompanied by currency depreciations and the catching up in domestic prices were clearly reminiscent of the previous widespread indexation and its destabilizing impact. Although considerable political and social constraints confronted the authorities, nevertheless recent developments raised a serious question of whether the program in actual performance had not already gone so far off track that damage might have become irreparable, at least within the limited time available to secure the credibility of both the authorities' adjustment efforts and the Fund's continued support of the program. In any event, a quick and successful correction of the present program slippages would require drastic adjustments in financial policies as outlined in the staff appraisal, with which he fully concurred.

Against that background, he welcomed Mr. Nebbia's assurance that his authorities remained firmly committed to the attainment of the goals agreed to under the program as well as the policy intentions presented in the authorities' recent letter to the Fund, Mr. Goos remarked. While he did not wish to question the seriousness of those intentions, he felt that experience under the program thus far could hardly be ignored when assessing the prospects for a timely reversal of the slippages. Nevertheless, he was prepared--albeit reluctantly--to give the authorities the benefit of the doubt in that regard. In doing so, he joined the staff in urging the authorities to do everything possible to reverse the existing program slippages without delay. In that context, he was concerned that the revenue measures necessary to achieve the critical reduction in the fiscal deficit were not yet in place and that the authorities had not been able to present a firm timetable for the overdue liberalization measures in foreign trade.

He could support the request for the waivers only with considerable reservations and in the firm expectation of an early correction of the program slippages, Mr. Goos emphasized. At the same time, he appealed to the Argentine authorities to bear in mind the potential detrimental effects on both their own and the Fund's credibility of any renewed failure to implement the necessary corrective steps. There was little doubt that policy performance in coming months would have an important bearing on the Board's consideration of the possible request for another stand-by arrangement with the Fund.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/100 (6/20/86) and EBM/86/101 (6/23/86).

4. BURKINA FASO - 1985 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies," attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1985 Article IV consultation with Burkina Faso to not later than July 21, 1986. (EBD/86/171, 6/18/86)

Decision No. 8314-(86/101), adopted
June 20, 1986

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/146 (6/19/86) is approved.

APPROVED: March 9, 1987

LEO VAN HOUTVEN
Secretary