MASTER FILES

ROOM C-130 04

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/95

3:00 p.m., June 9, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	L. K. Doe, Temporary
	D. C. Templeman, Temporary
	M. Lundsager, Temporary
	P. Péterfalvy, Temporary
	T. Alhaimus
	M. Arif, Temporary
H. Fujino	M. Sugita
G. Grosche	A. Bertuch-Samuels, Temporary
	Yang W., Temporary
J. E. Ismael	
A. Kafka	
T. P. Lankester	R. Fox, Temporary
	S. King, Temporary
	H. Fugmann
	I. Puro, Temporary
	L. Leonard
	G. D. Hodgson, Temporary
	J. M. Jones, Temporary
F. L. Nebbia	
	A. Ouanes, Temporary
	J. de la Herrán, Temporary
	G. Nguyen, Temporary
	V. Rousset, Temporary
	J. de Beaufort Wijnholds
	A. V. Romuáldez
	O. Kabbaj
	V. Govindarajan, Temporary
	L. Tornetta, Temporary

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

IBRD: M. R. Lav, East Asia and Pacific Regional Office, R. M. Westebbe, Western Africa Regional Office. Administration Department: G. F. Rea, Director. African Department: A. D. Ouattara, Director; G. E. Gondwe, Deputy Director; E. L. Bornemann, R. O. Carstens, U. Wilson. Asian Department: P. R. Narvekar, Deputy Director; H. Neiss, Deputy Director; B. B. Aghevli, S. M. Schadler, K. Yoshinari. Exchange and Trade Relations Department: E. H. Brau, J. H. Felman. Fiscal Affairs Department: P. S. Heller. IMF Institute: R. C. Barth; S. Kirakul, Participant. Legal Department: P. L. Francotte, J. M. Ogoola. Secretary's Department: A. Akanda. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, S. Ganjarerndee, J. Hospedales, R. Valladares, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, O. S.-M. Bethel, B. Bogdanovic, F. Di Mauro, J. J. Dreizzen, G. K. Hodges, J. K. Orleans-Lindsay, J. Reddy, D. Saha, B. Tamami, E. L. Walker, Wang X., B. D. White.

1. THAILAND - 1986 ARTICLE IV CONSULTATION, AND STAND-BY ARRANGEMENT - REVIEW AND MODIFICATION

The Executive Directors continued from the previous meeting (EBM/86/94, 6/9/86) their consideration of the staff report for the 1986 Article IV consultation with Thailand and the review under the stand-by arrangement (EBS/86/106, 5/9/86). They also had before them a report on recent economic developments in Thailand (SM/86/109, 5/23/86; and Cor. 1, 6/3/86).

Mr. Templeman said that he had mixed feelings about Thailand's economic performance during the past year, especially when measured against the high standards of performance usually expected from Thailand. Admittedly, the situation with regard to real economic growth, inflation, the balance of payments, exchange rate policy, wage restraint, and monetary policy had been favorable by international standards in the period since the Board's previous Article IV consultation discussion on Thailand (EBM/85/95, 6/14/85), but there remained a number of areas where economic adjustment and structural reform seemed not to be moving forward rapidly. The slippage in both the Central Government and public enterprises' fiscal position was the main problem, while continued weakness in the savings and investment balances and in the financial system as well as a high debt burden were also matters of concern.

In 1985, Executive Directors had expressed some disappointment that the staff and the authorities had not seemed to assign high priority to structural reforms, Mr. Templeman continued. For example, more attention could have been paid to trade liberalization. Some reductions in export taxes and subsidies had been effected during the previous year, but high tariff rates--about which some concern had been expressed in 1985--remained in place. He wondered whether the authorities had any specific plans in that area and whether trade liberalization should be embodied in future stand-by commitments.

The staff and Mr. Ismael had referred to plans for tax reform, but not many details had been given, Mr. Templeman added. Apparently there were problems in finance companies and other financial institutions and a fund had been established to help them. Also, weak competition in financial markets had apparently contributed to high real interest rates. And the overall deficits of the public enterprises, after falling steadily from 1980/81 through 1983/84, had begun to grow again in 1985.

Real economic growth in 1985 had been disappointing, at about 4 percent instead of the hoped-for 6 percent, Mr. Templeman noted. Admittedly, the weakness of foreign export markets had hurt overall growth. For 1986 he expected some acceleration of growth as a result of the drop in world oil prices, the decline in world interest rates, some recovery in export markets, and the overall improvement in Thailand's terms of trade. Over the long run, however, he continued to be concerned about the outlook for private fixed investment and about the apparent stagnation in the private domestic savings rate--less than 16 percent of GDP in each of the past three years. While he was not in a position to judge the viability of the proposed Eastern Seaboard Development Program, the doubts expressed by the Fund and Bank staff should be taken into account by the authorities before they moved forward on such a large endeavor.

The fiscal performance and outlook gave cause for concern, Mr. Templeman remarked. In 1984/85, the ratio of both the central government deficit and the consolidated nonfinancial public sector deficit had risen substantially above targets. The causes of the overshooting of the central government deficit seemed to have been due equally to revenue shortfalls and expenditure excesses. While the revenue shortfall reflected the lower than expected level of economic activity, they also highlighted the inadequacy of the tax structure. Overshooting of expenditures for capital spending, lending to public enterprises, and purchases of goods and services--partly through accelerated spending of current year appropriations and carryover spending from previous fiscal years--had demonstrated weaknesses in spending controls. The January 1986 tax package and indicative quarterly ceilings on spending had been introduced to improve the 1985/86 fiscal performance. However, at least on economic grounds, he was not persuaded by the arguments that the pace of reduction in fiscal deficits needed to be moderated in 1986 to allow continued economic recovery and to take into account that it was an election year. One year previously, the Board had been told that the authorities hoped to reduce the central government deficit to 3 percent in 1984/85 and to 2 percent in 1985/86. In the event, the 1984/85 deficit had risen to over 5 percent of GDP and the target for 1985/86 was currently 4.7 percent. Furthermore, the 1986/87 target was for only a reduction to 3.5 percent of GDP. While he understood the authorities' concern about not impeding economic recovery, there seemed to have been a substantial relaxation of fiscal goals, and he suggested that a stronger fiscal effort in 1986 and 1987 would be advisable.

The deficit ratios of the public enterprises in the three-year period 1984/85-1986/87 would actually be higher than in 1983/84, Mr. Templeman noted. While some steps had been taken to control the enterprises' foreign borrowing, to prevent and eliminate their domestic payments arrears, and to control their investment levels, there remained problem areas. For example, in the transport sector, a public campaign to educate the population concerning the link between realistic public tariffs and the investments needed to ensure adequate public services might be worth additional emphasis. He also looked forward to progress on privatization of public enterprises in some instances.

The staff report cited the low elasticity of the tax system as evidence of the need for repeated new fiscal measures to preserve the existing ratio of revenues to GDP, Mr. Templeman observed. The tax reform package introduced in late January 1986 was a positive response, as it would strengthen enforcement capacity, broaden the tax base, and reduce both corporate income tax and marginal rates for the personal income tax. However, the plethora of measures taken in the past few years and the still high marginal personal income tax rates tended to confirm the need for more fundamental reforms. He supported the Fund's provision of technical assistance in that area. He would welcome more information about the direction of the planned reform and whether it was realistic to expect that a comprehensive reform could be implemented before the end of 1986/87.

He commended the authorities for their ability to maintain a balance in 1985 between ensuring sufficient capital inflows and avoiding too restrictive a policy in the face of a slowdown in real growth, Mr. Templeman said. A similar delicate balance would be needed in 1986. He welcomed the decline in real interest rates from their previously high level, through discount rate cuts, moral suasion, and reductions in ceilings on rates. However, the continued use of formal ceilings was a sign of weakness in financial markets and seemed to attest to the inadequacy of competition; for example, he wondered whether foreign banks were allowed to operate freely in Thailand. Perhaps more fundamental reforms of the financial system might be needed in light of the apparently chronic liquidity problems of some financial institutions in Thailand.

Although Thailand had achieved the current account ratio target in 1985, that outcome had been in large part due to much lower than expected imports owing to a slowdown in domestic economic activity, which had offset the disappointing rate of export volume growth, Mr. Templeman remarked. The authorities' flexible exchange rate policies had led to a substantial real effective depreciation of the baht, beginning with the November 1984 devaluation, which seemed to have re-established Thailand's external competitiveness. However, exchange rate depreciation should not be used as a competitive tool to the exclusion of other ways of maintaining competitiveness, notably improvements in the overall efficiency of the economy. In fact, the staff's medium-term balance of payments and debt scenario, involving real growth in the 5-6 percent range in 1987-91, already presented a rather favorable external picture: by 1991, the current account deficit would fall to less than 1 percent of GDP; the ratio of debt to GDP would decline from 43 percent in 1986 to 33 percent in 1991; and the debt service ratio would drop from 27 percent of exports in 1986 to 22 percent in 1991. Even taking into account the sensitivity of the balance of payments to a higher oil price, higher world interest rates, and somewhat lower export growth, the medium-term outlook would not be substantially worse.

The Thai economy was essentially on the same path of economic adjustment expected when the current stand-by arrangement had been approved in June 1985, despite a somewhat disappointing year, Mr. Templeman concluded. He would have liked to have seen somewhat stronger macroeconomic adjustment and more attention to structural reforms and would expect to see some strengthening of the program in both areas. Nonetheless, he supported the extension of the stand-by arrangement through the end of 1987 and the rephasing of the anticipated drawings.

Mr. Fox said that he could support the proposed extension of the stand-by arrangement for Thailand, but slower pace of fiscal adjustment associated with that extension gave cause for concern. He sympathized with the authorities' desire not to compound the recession with too great a withdrawal of fiscal stimulus, and he acknowledged that on the basis of the fiscal impulse measure--which was welcomed in the case of a developing country--the fiscal stimulus provided in 1985 was at least being reversed in 1986. However, the programmed fiscal deficit for 1985/86 was significantly higher than in the two years prior to the current program. That increase would have been easier to justify if it had been due mainly to cyclical factors, but it had resulted largely from expenditure overruns owing to inadequate monitoring and controls and in particular to insufficient attention to actual inflation, which had been lower than assumed in the expenditure projections. The intended tightening up in those areas in the revised program was welcome, and Fund technical assistance would be helpful. Nevertheless, it was disappointing that more of the previous year's expenditure overruns would not be corrected during the current year. He had also expected that by the end of the original program, expenditures and the fiscal deficit would be decisively within the set limits; instead, both were still higher than intended. He would therefore welcome stronger fiscal adjustment in 1986/87, and he encouraged the authorities to explore the scope for intensified action in time for the next review of the program, which he hoped could take place significantly before the end-February deadline.

Monetary developments would also need careful monitoring, Mr. Fox continued. The sharp acceleration in monetary growth allowed for in 1986/87 was justified only if the declining trend in velocity was re-established, which itself assumed a recovery in private sector activity The authorities' undertaking to restrain credit expansion if that were not the case was important.

Intensified efforts would be needed to eliminate oligopolistic practices in the banking system, Mr. Fox observed. Also the more general structural weaknesses of the financial sector deserved close attention. He hoped that in the next paper on Thailand, prepared by the staff, a more extensive discussion of those problems, in view of their potential impact on the general macroeconomic situation, could be included.

External developments in the first quarter had been encouraging, with, for example, a record low trade deficit, Mr. Fox noted. He asked the staff to comment on that sector in the context of the medium-term projections, which were perhaps less optimistic than other speakers had suggested. He also wondered whether there had been any discussion with the authorities about a possible move to Article VIII status, which seemed a possibility in view of the absence of restrictions on current payments and transfers.

Mr. Nguyen said that 1985 had not been a very good year for Thailand. The drop in export earnings, combined with a decline in private investment and demand, had contributed to a weakening of the overall performance of the economy. As a result, the GDP growth rate had slowed to 4 percent, which, by Thai standards, could be considered low and disappointing. On the bright side, consumer prices had risen only 2.4 percent, even after allowing for the effects of the depreciation of the baht. With regard to the program targets, although the external objectives had been broadly met--perhaps not in the manner initially envisaged by the staff--public finances had shown some weaknesses on both the revenue and expenditure sides.

Given the continued slack in the economy and the poor prospects for a rapid recovery of Thai exports, he agreed with the decision to extend the program time period until the end of 1987, Mr. Nguyen continued. That would allow the authorities enough time to implement or strengthen the necessary adjustment measures--particularly on the fiscal front--while taking full advantage of the expected improvements in the financial situation owing to the oil price windfall and lower international interest rates. Together with short-term measures, structural reforms were called for on an urgent basis, especially with regard to the tax system, state enterprises, and financial sectors. The World Bank could play an important role, and he urged close collaboration between the Fund and the Bank.

The economic outlook, in the short and medium term, demonstrated Thailand's high sensitivity to external conditions, Mr. Nguyen commented. That situation underlined the importance of a flexible exchange rate policy and of measures aimed at promoting exports, as recommended in the December 1985 World Bank report, "Thailand's Manufactured Exports: Key Issues and Policy Options." The previous year's adjustment efforts had been hampered by factors largely beyond the control of the authorities; given Thailand's excellent record of close cooperation with the Fund, he was confident of the success of the program.

Mr. de la Herrân observed that 1985 had been a difficult year for the Thai economy. The combination of increasing protectionist measures and unfavorable terms of trade had brought about a contraction of economic growth, which had contributed significantly to preventing the country from making the remaining scheduled drawings under the stand-by arrangement with the Fund. However, in contrast with the average developing country, Thailand's economic situation was manageable.

The slippage in the fiscal area had been substantial, Mr. de la Herrân remarked. The authorities seemed to be facing the dilemma posed by a trade-off between the size of the fiscal deficit and the rate of economic growth. Pressured by what was, according to Thai standards, a sluggish growth pattern, the tight control over expenditures had been somewhat relaxed. In addition, the tax system did not appear to be sufficiently efficient, thus receipts had fallen short of what was required to offset, at least partially, the expenditure overruns that had taken place during 1985. The budget for 1986 represented an intermediate step toward the tighter fiscal stance projected for 1987. In view of the weak domestic demand still prevailing in the first part of 1986, the budget appropriately avoided further deflationary pressures. Table 6 of the staff report indicated that private domestic demand was projected to grow by 6 percent in 1986. In that case there would be a sensible reactivation of the economy with a wider margin for further fiscal retrenchment. He welcomed the ceiling on expenditures, the control on the rate of disbursements--as announced by Mr. Ismael--and the remodeling of the tax system. Technical assistance from the Fund could be of great help in reinforcing the elasticity of the fiscal system.

Sluggish domestic demand had also influenced the path of monetary policy, Mr. de la Herrân continued. That tool's accommodating role played thus far seemed to be changing, and it was taking a more active pace with the aim of providing an adequate level of credit to the private sector. Placing a ceiling on net credit to the Central Government was most appropriate; nevertheless, the major problem in that area related to the rigidity of domestic rates. Despite the drop in interest rates in foreign markets, domestic interest rates remained high, perhaps explaining the financing pattern shown in Table 7 of the staff report which illustrated the shift from domestic to external financing. Investment demand should participate more actively in the recovery of the economy; in 1983 private gross fixed investment had grown by 12.7 percent, while in 1985 it had dropped significantly, by minus 10.3 percent. For 1986 a return to positive rates was expected, but before that occurred, obstacles must be removed and interest rates would have to be adjusted to appropriate levels.

Like many other Asian countries, Thailand had surmounted adverse external shocks and had maintained a relatively strong external balance, Mr. de la Herrân commented. Despite protectionist trends and the drop in prices of some commodities, the current account deficit was lower than estimated under the program. In 1985, that deficit had been halved from its size only two years previously. His authorities were concerned about the prevailing protectionist trends in world trade. Perhaps the Thai economy had enough supply elasticity to absorb the adverse effects stemming from protectionist measures, but many other developing countries lacked that ability and had to bear the full impact of such trade barriers. The Thai authorities should also start dismantling their own protectionist system. Reciprocity must be applied in the right direction, by liberalizing trade.

The exchange rate policy followed by the authorities--pegging the baht to a basket of currencies instead of to the U.S. dollar--was appropriate, Mr. de la Herrân noted. The results had proved to be satisfactory, and the authorities should continue that policy.

With regard to the staff's short-term projection for GDP growth, the suggestion was that it would be sustained mainly through strong private fixed investment, Mr. de la Herrân said. He believed that private investment had not shown any signs of clear rehabilitation and that expectations were still based on an export pull. On public investment, he asked Mr. Ismael and the World Bank representative for comments on the port construction linked to a fertilizer plant project; there seemed to be some difference of opinion between the authorities on the one hand and the World Bank and Fund staffs on the other.

The Thai authorities merited the confidence of the Executive Board and he therefore supported the proposal to extend the stand-by arrangement through December 31, 1987, Mr. de la Herrân concluded.

Mr. Govindarajan stated that he supported the proposed decision.

The staff representative from the Asian Department said that preliminary figures just received for the first quarter of 1986 suggested that exports of manufactures had been robust, growing by 17 percent over the corresponding period one year previously. The strong performance of manufactured exports was broad based, but was particularly pronounced in the electronics sector which had been very weak the previous year. The growth in real GDP for the current year was likely to be closer to the upper end of the range of 4-4 1/2 percent projected earlier by the staff. Although exports were expected to weaken toward the latter part of the year because of problems related to tin and some major commodity exports, they should still exceed earlier projections. Oil import prices had dropped faster than anticipated in the staff report, and revised projections pointed to a current account deficit below the $1 billion forecast. The reduced deficit on current account was expected to lead to an improvement in the overall balance of payments position. Consequently, gross international reserves were projected to rise by close to $500 million, compared with the earlier target of $1,200 million--reserves would amount to about 4.0 months' imports, compared with the earlier projection of 3.6 months. Inflation was projected to remain low; prices had been rising at about 1 percent.

In the state enterprise sector, the availability and quantity of data had improved significantly in the previous year, but the timeliness could be further enhanced. The major responsibility for overseeing the public enterprise sector rested with the National Debt Policy Committee, whose authority had been expanded to include enterprises that requested any borrwoing--including domestic borrowing--requiring a government guarantee, as well as those enterprises that requested external financing. The State Enterprise Committee had been set up to undertake a systematic analysis of that sector, and while some progress had been made, more work remained to be done. Bureaucratic resistance had been encountered in many quarters and would have to be overcome.

The World Bank had been involved in the state enterprise sector, with special emphasis on those areas where the Bank had a financial arrangement, the staff representative noted. The Fund and Bank staff had been working together closely, and a Bank staff member had participated in the Fund mission. The Bank was specifically involved in the energy, telecommunications, and transport sectors. Unfortunately, in recent years the World Bank had not been involved in the Bangkok Metropolitan Transit Authority, which had encountered financial difficulties. The Government had prevented the Authority from proceeding with investment plans until its financial position had been improved by increased rates. Both the World Bank and the International Finance Corporation were actively involved in discussions with the Government to explore possibilities for privatization.

The level of interest rates exceeded significantly the domestic inflation rate and was broadly in line with foreign interest rates, the staff representative commented. Nevertheless, the stickiness of interest rates had led to inefficiencies in the whole financial system. Late in 1985, many banks in Thailand had strongly requested that the Bank of Thailand reduce the ceilings on interest rates; subsequently, commercial banks had lowered rates on savings deposits, for the most part voluntarily, by as much as 1/2 percentage point. That was an important development because banks had historically been reluctant to lower deposit rates for fear of losing markets. With fixed deposit rates, the term structure and lending rates had also become fixed, exacerbating the serious difficulties of the financial sector. In general, a more liberal interest rate policy would be desirable, but under current conditions there was limited room for maneuver. If individual banks' reluctance to lower interest rates were to result in excessively high interest rates, a substantial cost would be imposed on the whole system at a time when serious questions were being raised about the health of some of the institutions. Under the circumstances, the earlier approach by the Bank of Thailand of prompting a reduction in rates by lowering the ceilings could be justified. The Bank had announced that in future, to the extent possible, it would refrain from relying on ceilings for reducing market interest rates. Furthermore, the Bank was strongly committed to raising the ceiling rates, should that become necessary, because of upward movements in foreign interest rates or higher domestic inflation.

There were structural problems in the financial system, the staff representative continued; one was that a number of smaller family-run institutions with insufficient managerial experience and banking expertise that had been hit by the weakness in the economy had experienced serious financial problems. The authorities had introduced three decrees--which would have to be approved by Parliament when it reconvened following the elections--that enlarged the supervisory authority of the Bank of Thailand in dealing with banks and finance companies. The central bank was currently empowered, for the first time, to force the banks and finance companies to undertake appropriate remedies in a crisis. Nevertheless, it would take time for the financial system to overcome its current problems. To improve the managerial capacity of domestic banks, not only was the increased authority of the Bank of Thailand necessary but an expanded role for foreign banks was important. Although foreign banks had offices in Thailand, their operations were limited to Bangkok restricted to foreign exchange and trade transactions. Although the Bank of Thailand had publicly supported a more active role for foreign banks in improving the efficiency of the banking system, that approach had not been entirely shared by other parts of government.

On central government fiscal data, aggregate revenue and expenditure statistics for major items were available within two months, the staff representative remarked. However, there was a longer time lag on the externally financed components of expenditure. But overall, for the purposes of the program, the staff received reasonably accurate data within two months, which was the time lag allowed between the performance criterion and the purchase relating to that criterion at the end of the fiscal year.

Significant improvement was needed in the area of tax reform, the staff representative stated. The tax package of April 1985--as in the case of a number of previous tax packages--had been introduced quickly to overcome serious budgetary problems and without sufficient preparation, so that the results had been somewhat disappointing. Nevertheless, most of the shortfall in the overall revenues in the previous fiscal year had been due to the lower increase in nominal income, and the program target for the revenue/GDP ratio had been met. The measures undertaken earlier in 1986 were appropriate, especially those related to income tax and corporate tax. Although the revenue impact was minimal, the resulting structural improvements had been needed. Income tax brackets had been widened, resulting in a reduction in tax rates for any given income level, and the highest marginal rate had been reduced from 65 percent to 55 percent. Although the 55 percent maximum marginal rate was among the higher rates in the region, a number of countries had even higher maximum marginal rates. The exemption levels had also been raised, which would affect income distribution. Those two measures had been recommended for some time by the staff; they moved in the right direction and would not adversely affect income distribution.

Because experience in recent years with quick-fix tax packages had not been good, the authorities' commitment at the present stage of the program to undertake, with assistance from the Fund's Fiscal Affairs Department, an evaluation of the system and to determine remedies, was important, the staff representative continued. The Thai authorities had requested technical assistance to review taxation of income, wealth, consumption, and the external sector. The Fiscal Affairs Department had recently examined the taxation of consumption, and the major issue was the extent to which the system could move toward a business tax along the lines of a value-added tax. Less work had been done in the area of direct taxation and a study would look into the appropriateness of minimum exemptions, personal allowances and expenses, excluded assets and income, and the progressivity of the tax structure. The main issues involved in the corporate tax were the formulation of a corporate income tax rate, depreciation allowances, deductible expenses, exempted income, and the procedure for taxation of foreign income. The staff had believed that a tax package could not be implemented until the latter part of the fiscal year because elections had been scheduled to take place in April 1987 and allowance had been made for a new government to be established and to act on any recommendations. However, as elections were to take place earlier, the staff hoped that the new government would be in a position to implement the tax package earlier. If all phases of the study could be accelerated, there could be a significant impact on the fiscal deficit for the following year.

The authorities had requested that the tariff structure be studied as part of the tax reform package, the staff representative added. Such a study would call for close cooperation with the World Bank, which had been involved in that area. The Government had initiated a reform process in 1982, and significant progress had been made in the aftermath of the devaluation in November 1984, when import surcharges had been eliminated, resulting in a significant reduction in the effective rate of protection--by about 11 percentage points to 18 percent. Subsequently, in April 1985, tariffs had been increased for revenue purposes and the effective rate of protection had increased to 33 percent. On a sectoral level, the protection for agrobusiness had increased while that for other manufacturing had decreased. The anti-export bias of tariffs was a problem and needed to be studied.

The staff had encouraged the authorities to move to Article VIII status, and the authorities had indicated that they would keep that issue under review, the staff representative said.

Investment in the Eastern Seaboard Development Program was not a large proportion of total investment in the Sixth Plan, the staff representative observed. However, in view of the limited scope for cutting other investment projects, it was the only part of the investment program that allowed some flexibility for reduction. In particular, the construction of one port, which was tied to a fertilizer plant, was a much-debated issue within and outside Thailand. Based on the information provided to the World Bank, the port did not seem to be economically viable, and the authorities had been advised accordingly by the Bank. It remained unclear whether the fertilizer plant would be constructed, as financing problems had not been solved. The International Finance Corporation considered the fertilizer project to be viable. The port project would be kept under review; at present there was no indication that the Government would proceed. Alternative ports, with some modifications, could be used economically and the World Bank had recommended that course of action.

Mr. Ismael remarked that he was optimistic that the adjustment plan under way, together with the forecasted improvement in oil imports, would further strengthen the balance of payments. However, continuing source of concern was the outlook for commodities; unless the terms of trade for Thai exports improved significantly, uncertainty over the current outlook would remain.

During the previous five years, Thailand had continuously attempted to liberalize interest rates by encouraging commercial banks to fix their own deposit and lending rates within relatively high ceilings set by the authorities, Mr. Ismael stated. But the arrangement whereby banks were allowed to price their deposits and loans had not performed as expected. It had merely transferred the interest rate determining process from the authorities to the Thai Bankers' Association rather than to the individual banks, which had led to some inflexibility as the Association was dominated by the four largest banks, absorbing more than 70 percent of the market share. It had been observed that preserving the market share had always been the primary focus of the Association in fixing interest rates. Consequently, deposit rates were often set at the highest possible levels permitted by law, regardless of the prevailing liquidity situation in the financial system, whereas the loan markets were segmented, with favored customers receiving rates that were more in line with overseas funds, and the general public--with no ready access to foreign financing--often charged the prescribed interest ceilings. It would take time for the banking industry to restructure itself. Perhaps the key was the lessening of the degree of concentration within the banking system, either by the merger of smaller banks into larger ones that were more competitive or by encouraging new entries.

The steadily declining foreign interest rate since 1984, combined with the abundant domestic liquidity in Thailand, had resulted in a significant reduction in the prime rate, but deposit rates had remained more or less intact at an unrealistically high level until the recent government intervention, Mr. Ismael continued. Some banks had encountered financial difficulties in 1985 and early 1986 as a result of the reduction in the spread between average deposit and lending rates at a time when the economy had been weak and several large borrowers had been experiencing financial difficulties.

The major cause of the growing public sector current account deficit in the 1970s had been heavy investment expenditure, Mr. Ismael recalled. That was no longer the case. Since 1980, Thailand had experienced a steadily declining rate of national savings. The public sector savings ratio had deteriorated from close to 3 percent of GDP in 1978 to an average low of almost 1.5 percent during 1981-85. Since 1980/81, fiscal adjustments had been implemented frequently, some through Fund-supported programs. Strict measures had been taken since that time to generate revenue and restrain expenditure; but contrary to expectations, success so far had been moderate owing to a variety of factors, some beyond the authorities' control. Within the next fiscal year steps would be taken in the area of tax reform, where Fund assistance was requested. He was optimistic that those measures, including the recent improvement in tax administration, would improve public sector performance with the coming economic upturn.

Steady progress had been made in the state enterprise sector, Mr. Ismael observed. A critical factor was the tariff structure of those enterprises. The major energy pricing policy instituted recently should help to strengthen the financial position of that sector. In other areas, efforts were under way to phase out the less viable investment projects.

The Chairman made the following summing up:

Executive Directors were in agreement with the thrust of the staff appraisal for the 1986 Article IV consultation with Thailand and first review under the stand-by arrangement.

Directors noted that the external targets of the stand-by program had been broadly met, despite adverse external developments, such as the slow growth of export markets, weak commodity prices, and protection abroad against Thai exports. The devaluation of the baht in late 1984 and its subsequent depreciation during 1985, as well as weak import demand, had contributed to the sizable reduction in the current account imbalance and the stronger than expected overall payments position, which had allowed gross official foreign exchange holdings to remain at an adequate level. Directors observed that Thailand's performance in 1984/85 had been somewhat mixed. While inflation had been considerably lower than expected, economic growth had also slowed, and the fiscal target for 1984/85 had been significantly exceeded. In view of these developments, Directors emphasized that the adjustment effort should continue, and they welcomed the authorities' continued commitment to the objectives of the program. Directors supported the extension of the period for the stand-by arrangement, which would allow the authorities sufficient time to reduce the fiscal deficit and to achieve a sustainable external position within the program period. At the same time, several Directors urged the authorities to give greater priority to structural reforms, such as tax reform, reform of state enterprises, trade liberalization, and measures to increase flexibility in the financial system and to improve domestic savings.

Directors regretted that the fiscal deficit had exceeded the program target in 1984/85. Although it was understandable that revenues had been weakened by the slowdown in growth, the substantial increase in expenditure was a setback to the adjustment effort. Directors, therefore, welcomed the Government's commitment to contain the deficit for 1985/86 to a level below that in 1984/85, although some believed that the adjustment should have been more ambitious. While noting that the Thai authorities expected the fiscal deficit for 1987 to be reduced to about 3 1/2 percent of GDP, Directors encouraged further efforts to reduce the deficit below that figure. Directors noted that, in addition to the increase in tax savings on petroleum products, determined efforts would also be needed to control expenditure. For 1986/87, it was essential that there be more stringent efforts to control expenditure and raise revenues, so that the fiscal goals of the program could be met.

Directors believed that effective and comprehensive tax reform was urgent and of the essence; therefore, they strongly supported the proposed study of the tax system and urged the authorities to act on its conclusions without delay. Among other things, Directors pointed out that the elasticity of the tax system should be improved and that less reliance should be placed on the taxation of foreign trade.

The financial position of the state enterprise sector had weakened in 1985, largely as a result of the drain of resources from the Oil Fund but also as a consequence of an overrun in investment. Directors believed that further measures were needed to strengthen state enterprises. They welcomed the recent increases in tariff rates, particularly in the utilities sector, and the improvement in procedures for monitoring foreign borrowing by enterprises. With respect to the public investment program, Directors urged the authorities to be selective and cautious in initiating major investment projects. They hoped that the authorities would continue to rely on assistance from the World Bank in formulating both the tariff policy and the investment program.

Directors noted that, during 1985, domestic credit had been substantially below the program ceilings, owing to the weakness of credit demand. In this regard, Directors considered that the recent reductions in interest rates had been appropriate. Nevertheless, they cautioned the authorities not to become too accommodative and to avoid excessive credit expansion. Noting the rigidities in the setting of interest rates, a number of Directors urged the authorities to strengthen and liberalize the financial sector so as to improve its efficiency and competitiveness.

Directors welcomed the authorities' commitment to continue to manage the exchange rate flexibly so as to provide appropriate incentives for exports and to contain import demand.

Thailand continues to rely mainly on market mechanisms to support the agricultural sector and to promote nontraditional exports, Directors noted. Export diversification should be granted high priority in order to strengthen the medium-term outlook for the balance of payments.

Directors believed that the successful implementation of the adjustment program would result in a further improvement in the external position, while providing support for a recovery of domestic growth with low inflation. To that effect, the authorities should stand ready to take additional corrective actions if needed. Directors stressed that perseverance with the adjustment effort was essential in order to contain the growing debt service burden and maintain Thailand's standing in the international credit market.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

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

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

Decision No. 8299-(86/95), adopted
June 9, 1986

Stand-By Arrangement - Review and Modification

1. Thailand has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Thailand (EBS/85/128, Sup. 2, 6/18/85) and paragraph 28 of the letter of May 15, 1985 from the Minister of Finance and the Governor of the Bank of Thailand attached thereto, and has requested an extension of the stand-by arrangement to December 31, 1987.

2. The letter dated May 2, 1986 from the Minister of Finance and the Governor of the Bank of Thailand and annexed Technical Memorandum shall be attached to the stand-by arrangement, and the letter of May 15, 1985 and annexed Technical Memorandum shall be read as supplemented and modified by the letter of May 2, 1986 and annexed memorandum.

3. Accordingly,

(a) the period of the stand-by arrangement is extended to December 31, 1987;

(b) purchases under the arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 150 million until May 31, 1986; the equivalent of SDR 180 million until September 10, 1986; the equivalent of SDR 210 million until December 10, 1986; the equivalent of SDR 260 million until March 10, 1987; the equivalent of SDR 290 million until June 10, 1987; the equivalent of SDR 320 million until September 10, 1987; and the equivalent of SDR 350 million until December 10, 1987.

(c) Thailand will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Thailand's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(i) during any period in which the data at the end of the related month indicate that the limit on domestic credit, the limit on net credit to the Central Government, the limit on net foreign assets of the banking system, or the limit on new external public debt commitments, as described in the annexed Technical Memorandum, is not observed; or

(ii) during any period after September 30, 1986, if the limit on the deficit of the Central Government described in the annexed Technical Memorandum is not observed; or

(iii) during any period after February 28, 1987 and after June 30, 1987, respectively, until the reviews contemplated in paragraph 29 of the attached letter of May 2, 1986 have been completed and suitable performance criteria have been established for the remaining period of the arrangement, or, after such performance criteria have been established, while they are not being observed.

Decision No. 8300-(86/95), adopted
June 9, 1986

2. TOGO - 1986 ARTICLE IV CONSULTATION AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1986 Article IV consultation with Togo together with a request for a 22-month stand-by arrangement in an amount equivalent to SDR 23.04 million (EBS/86/103, 5/6/86). They also had before them a report on recent economic developments in Togo (SM/86/110, 5/23/86; and Cor. 1, 6/6/86).

Mr. Doe made the following statement:

Togo's adjustment efforts over the last several years continue to yield satisfactory results as documented in the excellent reports prepared by the staff. Economic activity expanded in 1985, inflationary pressures lessened, and the overall fiscal and external imbalances narrowed markedly. The Togolese authorities are furthering these gains in the context of a new program in support of which they are seeking Fund assistance.

Real GDP growth in 1985 was estimated to have exceeded the programmed projections and to be significantly better than the sluggish outturn of 1984. The expansion was most noticeable in trade, construction, and agriculture. The general upturn in economic activity in many of Togo's trading partners in the region, after several years of weak growth of recession in those countries, together with the favorable effects arising from the reopening of the Nigerian borders, contributed a great deal to the expansion of external commerce. Domestic trade was also spurred by the abundant harvest of food and several cash crops in 1985. The most important development in the construction sector was the beginning of the building of the joint Nangbeto hydroelectric dam, which when completed in 1988 will provide electricity at reasonable cost to Togo and Benin. In the agricultural sector, timely rainfall, except in the cocoa-producing areas, and strong government stimulus in the form of significantly higher producer prices reinforced the farmers' drive to increase output. As a result, sizable harvests were secured.

Progress toward the restoration of viability in public finance also continued, as evidenced by the reduction beyond program level of the fiscal deficit in 1985. This improvement in the fiscal position arose from a better than projected revenue performance on account of higher import tax revenue associated with the upturn of regional trade and the reassessment of tax liabilities of certain economic agents. Growth of total spending was restrained by the enforcement of several austerity measures put into place during the past years. Noteworthy was the freeze on wages and promotions of civil servants and the mandatory retirement of government workers who have completed 30 years of civil service. The continued levy of a 5 percent solidarity tax as well as the significant attrition in the civil service exerted a restraining effect on the wage bill.

The Togolese authorities also made significant gains relative to the program targets in reducing the external imbalances in 1985. Despite a sharp decrease in export receipts from cocoa--one of the main sources of foreign exchange--the external current account deficit was estimated to have fallen considerably, owing to lower than projected imports of capital and intermediate goods. The capital account balance was also strengthened a great deal, thanks to sharply higher than anticipated short-term private capital inflows. All in all, contrary to the program forecasts, the overall balance of payments showed a substantial surplus.

Building on earlier endeavors, the new program, as the preceding ones, aims at the twin goals of reinforcing the basis for sound economic growth and development and making progress toward the restoration of sustainable fiscal and external positions.

The momentum for growth, which began in 1984 and heightened in 1985, is forecast to continue in 1986 on account of expanding agricultural and commercial activities. Rural development focuses on enhancing nursery services, water supply, and credit facilities. Agricultural production continues to benefit from good price incentives. Efforts to restructure the public enterprise sector are also being pursued through further streamlining and increased supervision of the operations of public enterprises.

The relaxation of regulations governing the trading in some commodities is expected to stimulate commercial activities.

In the government sector, a small widening of the overall fiscal deficit is forecast in 1986 in anticipation of a deceleration in revenue growth coupled with a rise in total outlays. Though regional trade in 1986 has begun to gain some impetus, it is not expected to tanslate into a significant increase in imports in 1986. These prospects, combined with a substantial decrease in export earnings due to the sharp and continuous depreciation of the U.S. dollar, could weaken the tax base in 1986 and thus erode revenue growth. On expenditure, while maintaining the national solidarity tax and wage freeze, it was necessary to make allowance for a selective recruitment of some workers and the purchase of goods and other services in some critical areas. Additionally, a small increase in capital outlays is to be accommodated. The ensuing rise in total spending in 1986 should not be construed as a weakening of the resolve of the Togolese authorities to attain a sustainable balance between government receipts and expenditures in the years to come. Not only is the increase in projected total outlays lower than the rate of inflation in 1986, entailing a further erosion in real terms, but it is also in response to the need to avoid a paralysis of the administrative machinery at certain essential levels. Insofar as capital expenditure is concerned, it is my authorities' view that it would be unwise to weaken further the potential for medium-term growth by forgoing the implementation of development projects financed with readily available grants and highly concessional loans, only for the purpose of reducing the fiscal deficit.

In the context of policies defined cooperatively with the BCEAO (Banque Centrale des Etats de l'Afrique de l'Quest), the Togolese authorities continue to observe prudence and pragmatism with regard to money and banking, as stated in their letter of intent. Policies in these areas remain cautious so as not to ignite inflationary pressures. However, care is being exercised to provide sufficient credit for the financing of productive activities. To this end, the Togolese authorities are endeavoring to encourage deposit money banks to play a more active role in financing bankable projects of the private sector.

In 1986, developments in the balance of payments of Togo will be adversely affected by the size of the debt service obligations of the country and the depreciation of the U.S. dollar, in which the prices of Togo's main exports are quoted. Additionally, the demand for phosphates--Togo's main source of foreign exchange--is expected to be weak due to environmental considerations in some importing countries. The resulting fall in export earnings to a five-year low, together with a small rise in imports and high interest payments obligations, might lead to a significant deterioration in the external current account deficit. The combination of such an outturn with a weaker capital account balance, resulting from expectations of considerably lower short-term capital inflows and debt relief, could move the overall balance of payments from a surplus position back into deficit in 1986. My authorities are cognizant of this possible outcome and are actively exploring other export markets for their products. I should add that they have also taken measures, such as the elimination of export duties on locally manufactured goods which, in time, should enhance the competitiveness of Togo's exports and thus influence favorably the external sector's position.

For 1987, economic growth is projected to conform to trend, as the exceptional factors which contributed to the high rate of expansion registered in 1985 and anticipated in 1986 are not expected to be repeated. These include the particularly timely rainfall--a central element in explaining the past bountiful harvests of food crops--the commencement of the construction of the Nangbeto hydroelectric dam and the opening of the Nigerian border. Whereas construction and commerce are forecast to continue to influence positively real GDP, the value added of these sectors is not expected to depart significantly from normal trends in 1987. Similarly, climatic conditions are now forecast to follow a normal pattern so that food crop output in 1987 could fall back to a more normal level. As regards phosphate production, it is projected to remain stagnant, reflecting sluggish demand.

In the government sector, the preliminary forecasts indicate that the overall fiscal deficit might decline somewhat in 1987 on account of a projected better revenue performance. The recovery of exports in 1987, if it materializes, would undoubtedly strengthen conditions for income growth, with favorable spillover effects on consumption, imports, and thus tax revenue. The tentative nature of the 1987 fiscal projections should be underlined and, as stated by the staff, the first review of the program scheduled to be completed by end-February 1987, will provide an opportunity for the Togolese authorities and the Fund to examine in more detail the 1987 budgetary and other financial operations of the Government.

On present projections, the external account might globally evolve more satisfactorily in 1987 than in the present year. Principal in bringing about such an outcome is the projected rebound of exports. However, the projected evolution of the external accounts, just like that of the fiscal aggregates, is preliminary and subject to uncertainties. Unforeseen but adverse fluctuations in weather, export prices, and exchange rates could cause significant deviations from the present forecasts, as Togo remains very exposed to exogenous shocks.

This vulnerability of the prospective financial situation of Togo, and for that matter of several African countries, underscores the need for increased international cooperation in order to create an external environment that is propitious for sustained economic and financial expansion in the developing countries.

Over the period 1983-85, the external debt service obligations of Togo exceeded CFAF 161 billion. The debt relief granted by the Paris and London Clubs over this three-year period amounted to about CFAF 71 billion. Taking into account a net reduction of external arrears by approximately CFAF 14 billion, the net outflow of government resources on account of external debt service payments amounted to over CFAF 104 billion during the three-year period ended December 1985. This amount, which represents nearly 40 percent of all government receipts, may be contrasted with disbursements of external loans amounting to about CFAF 69 billion. Almost CFAF 50 billion is projected to be applied toward the payment of interest and principal each year in 1986 and 1987, representing 48 percent and 45 percent, respectively, of total revenue. These ratios are understandably even higher when the debt service payments are contrasted with tax revenue, rising from 51 percent during 1983-85 to projected levels of 63 percent and 59 percent in 1986 and 1987, respectively. This drain of resources constitutes a permanent subject of concern for the Togolese authorities because it places an extraordinarily heavy burden on the growth potential of the country. It is in order to prevent a worsening of the debt service burden in the years ahead, in the form of onerous debt rescheduling, that the Togolese authorities have decided to refrain from further restructuring of debt owed to Paris Club creditors. They remain, however, hopeful that the international financial community will continue to provide them with the assistance necessary to bring their adjustment efforts to fruition.

To sum up, following the reordering of their policies, the Togolese authorities have made major gains over the past few years toward reducing the economic and financial imbalances of the country. The economic upturn is firmly taking hold and the financial underpinnings of the economy have been strengthened. These achievements have entailed considerable human and economic sacrifice. The Togolese authorities are intent on furthering these achievements. However, it is also their view that it is unrealistic to expect that such sacrifices could be carried out indefinitely without reprieve. They would like in particular to stress that it is not realistic to aim at and work toward enhancing the productivity of the government work force, and by the same token the efficiency of public administration, in the context of a continuous decrease in real wages.

Mr. Rousset said that he fully supported the program, which sharply emphasized the structural policies needed to stimulate the Togolese economy over the medium term while recommending the continuation of the adjustment measures that had been implemented with great success over the past three years. He commended the Togolese authorities for the commitment they had consistently shown to adjustment over the years. As a result of fiscal discipline, the budget had become more buoyant. Revenues had increased, owing to the implementation of the tax reform and the strengthening of tax collection. Current expenditures had been kept under strict control, as evidenced by the unchanged size of the wage bill in relation to 1982 figures and the freeze on hiring and promotions.

At the same time, there had been a small but encouraging decrease in the burden of external debt, Mr. Rousset continued. Not only had the outstanding amount been reduced by 8 percent in 1985, but its structure had been modified to increase the share of concessional aid and, as a result, the average lending rate had been brought down from 6.5 percent in 1984 to 5.9 percent in 1985. Although the debt service might nevertheless seem considerable, in recent years Togo had benefited from a number of grants and loans greater than the repayment of its debt. Consequently, the normal servicing of the debt had been possible without placing an unbearable strain on Togo's investment potential. Provided external assistance was maintained at the same level, that trend would enable Togo to expect a way out of its debt crisis by 1989 without having to seek a rescheduling of its debt as of 1987.

All those developments augured well for the future, Mr. Rousset observed. The authorities were fully convinced of the impossibility of any sustainable progress without imposing a program of strict financial management. He was therefore confident that they would pursue a rigorous financial policy and apply all their efforts to avoiding any slippages in budget expenditures. However, if financial adjustment was a necessary requirement for the renewal of economic growth, it was not sufficient by itself to trigger and later sustain economic activity. He therefore welcomed the program under consideration because it focused on several structural measures aimed at providing incentives to the private sector and at improving the overall climate for renewal.

The program provided for an impressive acceleration of the restructuring of public enterprises already under way, as shown in Appendix V of the staff report, Mr. Rousset noted. He would be interested in the comments of the World Bank's representative on the progress made and, more specifically, on the time discrepancy between the closing of some of the enterprises and the implementation of further measures aimed at their privatization, restructuring, or liquidation. He also wondered what the response of Togolese investors had been to the Government's offer to buy some of those enterprises.

The agricultural sector was an area where the authorities could fully expect a quick and positive reaction to their decision to raise producer prices, suppress state monopolies, and liberalize cereal exports, Mr. Rousset commented.

The greatest efforts were required in the industrial sector, as past experience had demonstrated that the private sector had been more inclined to promote import-export activities than investment in industrial production, Mr. Rousset observed. Attracting investors to that sector entailed an important shift in outlook and would require the creation of strong incentives for productive investment and the support of an efficient financial sector. That last point deserved the authorities' thorough consideration since in the past, commercial banks had been reluctant to extend credit to private productive investments despite an abundant liquidity position. It was therefore encouraging that the matter would be carefully examined; the establishment of a guarantee fund was one step in that direction. In conclusion, he supported the proposed decision.

Mr. Kabbaj remarked that Togo's economic and financial performance since the previous Article IV consultation (EBM/85/74, 5/17/85) had markedly improved the economy's overall outlook, although some of its imbalances and weaknesses would continue to require strong adjustment efforts over the medium term. While such improvement had been to a significant extent influenced by more favorable exogenous factors, including the reopening of the Nigerian border and good weather conditions, the positive results of 1985 should be credited to the authorities' determination to achieve--in cooperation with the Fund, the World Bank, and donors--an appropriate degree of stabilization and to introduce far-reaching structural reforms.

Togo had successfully implemented three successive annual Fund arrangements, meeting all related performance criteria and quantitative targets, Mr. Kabbaj continued. The policies implemented over the previous three years had permitted the elimination of domestic and external arrears as well as the containment of fiscal and external current account deficits at levels compatible with available foreign financing. The program's structural reforms had also started to have positive effects on exports and growth, as illustrated notably in the agricultural sector where the adoption of more remunerative producer prices for the main export crops and the realization of crop development projects had induced an encouraging response from farmers. Major structural reforms had also been introduced with respect to the private investment code, to public investment programming with the adoption of a three-year rolling investment program, and to public enterprises where government efforts had been aimed at enhancing efficiency in those enterprises to be retained and at closing or privatizing those that were unprofitable.

Those reforms and tight financial policies--as well as the support of the Fund, World Bank, and creditors--had led in 1986 to the strongest economic performance by Togo in many years, Mr. Kabbaj noted. Real GDP growth had been relatively strong at 4.7 percent, compared with 1.3 percent in 1984, estimated inflation had been sharply reduced, government and external current account deficits had been further reduced in terms of GDP, and international reserves had strengthened. For the first time in several years, Togo had also significantly reduced the ratio of outstanding external debt to GDP and, according to projections for 1986 and 1987, the country would not need new debt rescheduling. While the reduction in the debt service ratio reflected to some extent the appreciation of the CFA franc vis-à-vis the U.S. dollar, it was mainly due to the implementation of adjustment programs and to Togo's cautious debt management, as the authorities had refrained from external borrowing on commercial terms to finance projects since 1980.

In spite of a commendable performance, Togo's economic and financial difficulties remained a matter of concern, Mr. Kabbaj said. In particular the excessive dependence of the economy's performance on weather conditions and concessionary assistance, the still large fiscal and external deficits excluding grants, the very modest GDP expansion compared with an annual population growth of 2.9 percent, and the heavy burden of external debt, which, notwithstanding its concessionary nature and its improvement, still represented over 100 percent of GDP, were worrisome. The authorities' request for a new stand-by arrangement and the implementation of a second structural adjustment credit with the World Bank were indicative of their determination to continue to tackle those difficulties.

He welcomed the authorities' request and shared to a large extent the staff appraisal of the 1986/87 program, which should consolidate the financial performance of the past few years and strengthen ongoing structural reforms, Mr. Kabbaj stated. Nevertheless, the implementation of some structural reforms had suffered from a lack of resources--both trained manpower and supplies--largely owing to substantial cuts in current expenditures and to civil service wage and recruitment policies under the programs. While the proposed financial program provided for measures to remedy that bottleneck, including new recruitment of skilled personnel and increased outlays for supplies and equipment, they did not appear to be sufficient to deal with the situation, especially as the freeze on wages and promotions would remain in effect for the fourth year and could seriously affect the administrative system's ability to retain trained professionals and to implement effectively the adjustment program.

The expansion of private investment and bank credit to the private sector had been a crucial element of Togo's structural reforms, including those under the proposed program, Mr. Kabbaj noted. However, performance in that regard had been below expectations. The staff linked that development to the sluggish demand for credit but also to "local banks' reluctance to extend credit for private investment in Togo." He asked the staff to comment on the reasons for that reluctance and on how it was addressed in the proposed program.

Although medium-term projections showed a steady improvement in Togo's balance of payments position depending on the authorities' ability to sustain its strong adjustment efforts and to attract adequate levels of concessionary flows, that performance also depended on two important factors beyond Togo's control: weather conditions and the international price of phosphates, Mr. Kabbaj remarked. Phosphate exports represented about 40 percent of total exports. Should the recent trend of depressed prices continue, it could seriously affect Togo's prospects. While the Fund and donors should show some flexibility to ensure that such a development did not adversely affect the momentum of adjustment, the new program should emphasize the need for investment diversification so as to shield the economy from unfavorable exogenous factors.

The proposed program could have been more ambitious especially with respect to growth, not only in view of the progress already achieved in stabilizing the economy but also in light of the low growth record of the past few years, except 1985, Mr. Kabbaj commented. While the program allowed increased investment outlays, the projected expansion of GDP did not seem to be adequate to deal with Togo's relatively high population growth and the need to strengthen its debt-servicing capacity. Higher growth objectives would imply more external assistance than projected, including assistance from the Fund, and perhaps new debt rescheduling; Togo's circumstances justified both. Finally, he supported the proposed decisions.

Mr. Grosche observed that Togo had made commendable progress under the previous three Fund-supported programs. In fact, at the completion of the proposed fourth stand-by arrangement, Togo could be expected to have restored a sustainable internal and external financial position, which would obviate the need for further recourse to regular Fund resources.

For the first time in recent years, Togo had managed to reduce its external debt relative to GDP, Mr. Grosche continued. The country was in a position to forgo further debt rescheduling and to bring down the debt/GDP ratio by 1990 to less than two thirds of its 1983 level. Of course, that would not have been possible without the generous support of donors and creditors, but the authorities deserved full credit for having prepared the groundwork on which external assistance could be utilized to its full potential. Moreover, Togo was a heartening example of the effectiveness of a comprehensive adjustment effort, involving all parties concerned--especially the close collaboration of the authorities, the Fund, and the World Bank. He welcomed the increasing emphasis being placed on structural adjustment, in particular with a view to increasing the private sector's role in the economy.

The new program was well conceived, consistent, and properly financed, and it thus represented another important step toward sound development and growth, Mr. Grosche remarked. Especially positive in the context of the overall development strategy was the fact that special attention had been given to the financing of follow-up costs of investment projects and the tendency among donors to provide such financing.

Togo's debt-service burden remained high and it was therefore important for the authorities to be fully aware that they could not afford to rest on their laurels but must continue to consolidate the gains made thus far, Mr. Grosche remarked. Prudent fiscal and monetary policies were a prerequisite for the success of the structural reform program. He therefore welcomed the authorities' intention to further reduce the fiscal deficit in 1987 after the temporary pause in 1986 because of the need to correct certain shortages of supplies and qualified personnel.

The possible loss of competitiveness and the deterioration in the balance of payments resulting from the appreciation of the CFA franc gave cause for concern, Mr. Grosche said. While he recognized that Togo, as a member of the West African Monetary Union, could not by itself influence exchange rate policy, he nevertheless wondered whether a collective effort of all members could not be made to inject more flexibility into the exchange rate system. That would seem particularly important if the U.S. dollar continued its decline. The other members of the Monetary Union would also be adversely affected by an appreciation of the CFA franc. He would appreciate any comments by the staff on that issue. He supported the proposed decisions.

Mr. Jones observed that the positive developments in the Togolese economy in recent years bore witness to what could be accomplished when the essential ingredients of an adjustment program were in place: the authorities' firm commitment to the adjustment process, a coherent set of policies, and the availability of adequate financing. The economic policies outlined by the Minister of Economy and Finance attested to the willingness of the authorities to continue along the path of adjustment. In view of the success that the authorities had achieved in implementing corrective policies previously agreed with the Fund, he could fully endorse the proposed stand-by arrangement.

The staff suggested that the Togolese economy would continue to make progress in coming years, Mr. Jones noted. He agreed, mainly because of the apparent awareness of the authorities of the need to take a comprehensive approach to tackling the economic problems of the country. Whereas at the start of the adjustment effort in 1983 the emphasis had been placed on austerity measures in the public sector, the 1984 and 1985 programs had gone a long way to incorporate a number of features aimed at improving performance in the real sector of the economy. That process was continuing with the streamlining of the Government's investment program, the further liberalization of the economy, and the steps being taken to foster the development of private entrepreneurship. Efforts aimed at improving the performance of public enterprises and at closing the unprofitable ones also fit into the general scheme of making the economy more productive.

Nevertheless, the Togolese economy was not assured of smooth sailing in the years ahead, Mr. Jones remarked. There were two potential constraints over the medium term: the slow growth of exports and the heavy debt service burden. In the circumstances, the sustainability of the country's external payments position over the medium term hinged on the assumption of a continued high level of donor support in the form of both project and nonproject assistance. Although the staff's scenario described what was likely to happen in the Togolese economy, the situation remained fragile given the uncertainty surrounding some of the key assumptions that formed the basis of the forecast.

Since budgetary contributions from the phosphate company and the Agricultural Marketing Board--the two most important public enterprises--depended upon developments in the export market, he wondered whether there was a contingency plan if those companies were unable to meet the payments schedule for 1986 as attached to the letter of intent, Mr. Jones said. He also wondered whether agreement had been reached with the World Bank on the sectoral composition of the Government's investment program. Such an agreement was necessary before the second tranche of the structural adjustment loan could be released. He also asked the staff to comment on why the local banks were reluctant to extend credit for private investment in Togo and how the Government reconciled that situation with the added emphasis being given to the promotion of private sector activity.

Mr. Wijnholds said that he supported Togo's request for a new 22-month stand-by arrangement amounting to 60 percent of quota. Togo's record of program implementation was commendable, and it was heartening to see that the adjustment efforts of previous years were starting to show results on both the external and internal sides. He welcomed the Fund's and the Bank's collaboration in Togo and the Bank's two structural adjustment credits, which were helping to bring about economic reforms aimed at the medium and long term. Under those circumstances, Togo should be able to qualify for assistance under the structural adjustment facility without undue delay.

After three years of Fund and Bank involvement, the basic policies needed for sustained growth with low inflation and a viable external position were in place, Mr. Wijnholds stated. Pricing policies of public enterprises and agricultural producer prices had been adjusted substantially and--more important--the fiscal deficit had been narrowed as a result of increased revenues and stable current expenditures. In that connection, the radical program of reduction of government employees was noteworthy. Furthermore, monetary policy had been conducted prudently, and real interest rates were positive at the current low level of inflation.

Togo was embarking on the next phase of the adjustment process with investment projects under way that should alleviate further the external debt-servicing problems in a number of years, Mr. Wijnholds remarked. He welcomed the further incentives that were being provided for the private sector by means of a reduction of the state import monopolies and the liberalization of cereal exports. Those measures should boost private commercial activity and agricultural production. Nevertheless, it should not be overlooked that recent good economic performance had been due not only to adjustment efforts but also to favorable weather conditions. Therefore, to sustain a satisfactory economic performance, there could be no letup in crucial areas such as fiscal policy. Furthermore, a continuation of the adjustment effort over the medium and long term was needed, especially with respect to structural adjustment.

The essence of the medium-term outlook was captured in Chart 4 of the staff report, which showed a steady further decline in the external current account deficit and the fiscal deficit in terms of GDP and a decline in the debt service ratio to a less uncomfortable level by 1990, Mr. Wijnholds said. Moreover, no further debt rescheduling was assumed. Of course, that would require a continuation of the high aid inflows that Togo had enjoyed, which was closely connected to continued satisfactory adjustment efforts. There had been a remarkable improvement in the terms of external public debt in Togo, with the average interest rate on new commitments declining from 7.8 percent in 1975 to about 3 percent in 1983-85 and the average maturity increasing substantially. Another favorable element on the financing side had been the much larger than expected inflow of short-term private capital in 1985. He asked the staff or Mr. Doe for an explanation of that development, and whether confidence had been a factor.

Ms. Lundsager observed that the consistent and comprehensive adjustment effort in Togo was continuing. Performance in 1985 had surpassed expectations, with smaller than programmed fiscal and current account deficits. Real economic growth had been much higher than expected, and inflation had virtually disappeared with good harvests and resulting food price declines. Those developments had been due in part to favorable weather conditions, although they also indicated that the adjustment efforts of the past several years were bearing fruit. She welcomed the Togolese authorities' decision not to seek further debt rescheduling and the staff's assessment that the new stand-by arrangement could be the last in a series of formal Fund arrangements. That assessment indicated that the payments position was expected to become viable soon and, more important, that the authorities could maintain their adjustment momentum in the future, having experienced the benefits to their economy that could be obtained by such an effort.

Under the current program, a realistic approach appeared to be envisaged for producer price adjustments, depending on developments in world market prices for the various crops, Ms. Lundsager noted. Care must be taken to preserve producer incentives, and in that respect Mr. Grosche's questions concerning the exchange rate were relevant. Further stimulus to supply could also emerge from the decision to eliminate export quotas on food crops. Several other structural adjustments were particularly important, including the elimination of export taxes on manufactured goods and the disbanding of import monopolies. Stimulating further competition in the marketing of imports could strengthen the role of the private sector in the economy and help maintain the already low inflationary pressures.

The banking system appeared to be fairly liquid, with resources that could be lent to the private sector for investment, including the acquisition of divested public enterprises, Ms. Lundsager continued. However, difficulties in undertaking domestic investment remained, despite the newly revised investment code. The authorities should reduce and eliminate those remaining administrative and other impediments to private domestic investment. Perhaps such an approach could reduce the need for sectoral credit coefficients.

The authorities had made important efforts in the public enterprise sector, Ms. Lundsager added. The authorities should follow through expeditiously with further reforms, and divestment where appropriate, of the remaining public entities. She wondered what was the scope for increased competition with respect to the marketing boards. It appeared that deregulation and increased competition in the food crops sector had paid off, and she asked the staff to assess similar possibilities in the export sector.

She had no problem with the relatively stable fiscal deficit, Ms. Lundsager commented. External grants were high, and with continued good economic performance Togo could maintain external support. Furthermore, investment continued to be high and apparently productive, with World Bank programs assisting in prioritizing projects. The remaining small fiscal deficit after grants appeared to be financed with concessional external financing and limited domestic financing. Nonetheless, although she could sympathize to some extent with the increase in some current expenditures--given the need to replenish depleted supplies and to hire skilled personnel--care must be taken to maintain the fiscal effort the following year and beyond so as to ensure the sustainability of the external position and further reduce the external debt burden. Ongoing implementation of the recent tax reform should help in that regard, as would further administrative improvements and continued restraint on noncritical expenditures. In the tax reform effort, continued attention should be given to strengthening incentives for savings and investment.

The external current account deficit was expected to remain high in the next two years, even after transfers, although a large part was attributable to the hydroelectric project for which concessional financing had been obtained, Ms. Lundsager remarked. The favorable medium-term outlook provided some assurance, with the current account deficit--including grants--expected to be virtually eliminated by 1990 and the external debt burden expected to drop significantly. That scenario also indicated that reliance on phosphate exports. Possible areas for further structural reform would be considered in more detail during the discussions on the drawing under the structural adjustment facility, he therefore asked the staff or Mr. Doe for information on the timetable envisaged for that discussion.

The need to achieve greater export diversification also emphasized the importance of maintaining adequate domestic competitiveness, Mr. King added. Because of the authorities' participation in the fixed exchange rate system associated with the West African Monetary Union, they would need to monitor domestic costs and prices carefully to ensure that they did not get out of line with those of Togo's trading partners. The staff's medium-term scenario assumed an average inflation rate of about 5 percent a year until 1990; he asked the staff to explain how that would compare with the rate in Togo's main trading partners and what the implications might be for competitiveness.

Both the Fund and the World Bank currently had resident representatives in Togo, Mr. King noted. He wondered whether there had been any instances of one representative reporting to both institutions, where management judged that to be feasible and appropriate. Both costs and advantages could arise in such situations.

Mr. Ouanes observed that a close look at successful Fund-supported programs in Africa revealed the existence of a number of common features. First, those programs had, without exception, been associated with a strong and determined commitment of the authorities to the adjustment process. Second, the World Bank had had a deep and sustained involvement in the orientation of the investment program and the design of supply-side policies. Third, those programs had required a close collaboration between the Bank and the Fund in the formulation of adjustment strategy and in the timing and implementation of adjustment measures. Fourth, increased coordination and the provision of financial assistance among donor countries had also characterized successful programs.

Those elements had all been present in the case of Togo and had resulted in the successful implementation of a series of Fund-supported programs, Mr. Ouanes continued. The firm commitment of the Togolese authorities had been demonstrated in the far-reaching measures adopted thus far. In 1982, the authorities had launched a comprehensive adjustment effort, which they had sustained since that time. Their efforts had been focused on strengthening the fiscal position and encouraging the agricultural sector.

In the fiscal area, the authorities had revised the tax code, strengthened tax administration, and, most notably, had restructured the state enterprises, Mr. Ouanes remarked. In addition, the authorities had shown political courage by restraining current expenditures directly through a freeze on wages and promotions of civil servants, and indirectly through a 5 percent national solidarity tax on wages and salaries levied at the source. For example, in 1985 personnel and other current expenditures--excluding interest payments on external debt--had been, in nominal terms, below their 1982 level, implying a decline close to 16 percent in real terms.

In parallel to the fiscal restraint, the Togolese authorities had followed pricing policies that included a considerable increase in producer prices of main agricultural products, Mr. Ouanes said. Those policies had not only spurred a healthy growth in the agricultural sector but had also contributed to a more diversified export base. Togo's investment policy had also been reoriented, with the bulk of public sector investment going to rural development.

All those measures had clearly demonstrated the determination of the Togolese authorities not only to reduce the internal and external imbalances but also to lay the foundation for sustainable growth within the framework of a viable balance of payments, Mr. Ouanes commented. Particularly impressive was the fact that priority had been given to the full settlement of external arrears despite sacrifices.

The added emphasis in the 1986/87 program on structural adjustment measures within the framework of enhanced World Bank support was welcome, Mr. Ouanes said. That emphasis was crucial if the adjustment process was to be growth oriented. Despite commendable achievements in the agricultural sector, however, the average overall growth rate had been sluggish in the past five years, suggesting that future growth prospects for the Togolese economy would have to originate outside that sector. He asked the Fund or World Bank staff to comment on the potential sources for future growth in Togo.

The stronger emphasis on the promotion of the private sector and the increased reliance on market mechanisms for resource allocation were also welcome, Mr. Ouanes added. The ongoing efforts to restructure and privatize the public sector enterprises were commendable. A number of countries in Africa and elsewhere could benefit from the Togolese experience in that area. However, a meaningful improvement of private sector participation in economic activity must include reform of the financial system in Togo. The present banking system was not sufficiently efficient in financial intermediation and, in particular, in meeting the growing private sector demand for credit, despite high liquidity positions.

While the overall deficit was programmed to remain virtually unchanged at 6.5 percent of GDP, the composition of government expenditures was expected to improve, Mr. Ouanes noted. In particular, government savings were expected to increase over the program period, thereby releasing much-needed resources to finance the private investment program. However, further improvements would be needed in the areas of budgeting and tax administration and in correcting procedural weaknesses. Perhaps Fund technical assistance in that area was warranted.

While the outlook for the external sector was for an improved performance, the high level of external debt in light of the weak prospects for Togo's major exports was a cause for concern, Mr. Ouanes commented. He therefore welcomed the authorities' commitment to further improve the debt profile and to reduce external debt service obligations in the medium term. He agreed with Mr. Doe that the drain on resources on account of external debt placed "an extraordinarily heavy burden on the growth potential of the country." However, Table 9 of the staff report indicated that both the debt outstanding in relation to GDP and the debt service ratio would decline substantially over the medium term.

The Togolese authorities had demonstrated their firm commitment to a comprehensive adjustment process, Mr. Ouanes remarked. Their good track record in implementing Fund-supported programs and in settling their external obligations was commendable. Their performance over the past few years merited the continued support of the Fund, in terms of both the present stand-by arrangement and the structural adjustment facility. He therefore supported the proposed decisions.

Mr. Arif commented that after the unsuccessful implementation of the two Fund-supported financial programs during 1979-82, the highly satisfactory performance of the Togolese economy in the three subsequent years was encouraging. That performance underlined the consistent and determined efforts of the authorities to streamline the economy and the positive response of the international community in not only lessening the burden of existing debt but also providing additional concessional aid to support those positive developments.

The results recently achieved in Togo constituted a happy contrast to the situation prevalent in many countries, Mr. Arif observed. The economic outcome in 1985, which marked the third consecutive year of successful program implementation, indicated an improvement in almost all sectors compared with the program target as well as with the revised midterm estimates. That improvement was discernible in GDP growth, export performance, restraint on imports, expansion of revenue receipts and domestic investment, containment of the fiscal deficit, and reduction in the debt service ratio. Other important developments included the emergence of a sizable overall balance of payments surplus, compared with a large anticipated deficit, and the declines in consumer prices and the GDP deflator despite the substantial increases in charges for various utilities.

The successes during the past three years had been achieved in the context of the Fund's stand-by arrangement and the World Bank-supported structural adjustment program, Mr. Arif continued; emphasis had been placed on public finance and public enterprises, the size and strategy of the overall investment program, and agricultural and rural development.

In the fiscal area, the current focus on implementing the revised tax code and strengthening tax administration was most appropriate as it would help to make the tax system elastic and resilient, Mr. Arif remarked. He commended the authorities for effecting rate increases for various utilities that were sufficient to cover both their operating costs and outlays for capital projects. Owing to those and similar measures, and notwithstanding the larger than planned investment expenditure during the year, the overall fiscal deficit in 1985 had turned out to be the lowest in the 1980s thus far.

Nevertheless, the squeeze on current outlays--including maintenance, wages, and personnel--had already had an adverse impact on the efficiency of public services and governmental operations, Mr. Arif considered. That phenomenon was not peculiar to the Togolese economy alone; it was experienced in many developing countries and was obviously counterproductive. The Togolese authorities seemed to be aware of the problem, as indicated by the inclusion of certain current outlays--such as those related to road maintenance--in the investment program. The staff had appropriately provided for adequate maintenance costs of major projects and other public investments in its medium-term scenario. The strengthening of the fiscal sector was also being sought through privatization of more public enterprises and the comprehensive restructuring of those remaining.

Despite the generous cooperation from its public and private creditors, Togo's debt service ratio remained high, Mr. Arif noted. Partly because of its desire to minimize its need for external capital inflows, Togo had fixed the size of its investment program at a sustainable level and had reoriented its development strategy from industrial enterprises toward agricultural and rural development and rehabilitation as well as the maintenance of existing infrastructure. The significant increases in prices of cash crops effected recently had helped production and exports, but further recourse to that device in the near future would not be possible. That factor, combined with the recent appreciation of the currency vis-à-vis the U.S. dollar, would keep the performance of traditional exports modest in the medium term. Hence, export diversification and efficient import substitution had been suggested as an alternative strategy. Although Togo's domestic and external financial position appeared sustainable through the medium term without further debt rescheduling, projections for 1986 and 1987 reflected larger current account deficits than the one recorded in 1985, and a reversal of the overall surplus achieved in the past year to deficits in 1986 and 1987. That trend reflected the external sector's current weakness, which he hoped would be overcome over the medium term. In conclusion, he supported the proposed decisions.

Mr. Govindarajan noted that under three Fund-supported programs and two World Bank-supported structural adjustment programs, Togo had made significant adjustment efforts for which the authorities should be commended. Moreover, generous aid donors' support in the form of concessional assistance and recent favorable external circumstances, which had enabled Togo's exports to increase, had helped Togo in undertaking those efforts.

He agreed with Mr. Doe's observation that it would be unrealistic to expect efficiency in public administration if real wages continued to decline, especially in view of the very stringent measures--such as the wage and promotion freeze--that had been undertaken by the Government in recent months, Mr. Govindarajan continued. Government wages had not been increased since 1982, and represented a major sacrifice on the part of the Government. There were no specific performance requirements in that regard, and he hoped that the staff would continue to show some flexibility.

The staff had noted that as a result of Togo's adjustment efforts, the medium-term outlook had improved and Togo's internal and external financial position should become sustainable with continued donor support, Mr. Govindarajan noted. The ability of Togo to continue its adjustment efforts would depend crucially on the availability of adequate concessional external assistance while tackling its external debt prospects. He hoped that the international community--including the World Bank--would continue its timely and adequate assistance to Togo, especially in view of the country's excellent adjustment record, in terms of both cooperation with the Fund and implementation of the adjustment programs. He could support the proposed decisions.

The staff representative from the African Department said that the Togolese banks' reluctance to lend to industry or private investors was probably because those banks had been created to finance exports and imports. As the financial system developed, the banks would undoubtedly start using their liquidity in Togo. Discussions between the banks and the authorities were under way to find ways to alleviate the banks' reluctance.

The flexibility of the exchange rate system had been discussed many times and involved the costs and benefits of membership in a monetary union, the staff representative commented. Because the authorities believed that the benefits outweighed the costs, Togo had remained within the union and consequently the exchange rate system; therefore the program emphasized fiscal, wage, and other policy instruments.

The Office Togolais des Phosphates (OTP) and the Office des Produits Agricoles du Togo (OPAT) made important contributions to the budget, the staff representative remarked. Indeed, their part of the budget was so large that no contingency plan had been drawn in case the contributions were not made. Of course, if the differences were small, other means of financing could be found.

The amount of the investment program discussed with the World Bank had been shown in the staff's overall scenario, the staff representative continued.

The short-term capital inflows were perhaps due to the country's considerable stability, the staff representative observed. As a consequence, overall balance of payments surpluses had been recorded in the past, but it could not be assumed that that would continue every year.

Diversification of Togo's export base was possible, and in fact the staff had built it into the program, the staff representative said. However, before proceeding, the results of an audit of OPAT and of the liberalization of food crop exports should be examined.

During its visit to Togo in February-early March, the staff had tentatively discussed with the authorities the use of resources under the structural adjustment facility, the staff representative recalled. It had been agreed to continue discussions during the review mission scheduled for November 1986 so that a drawing could possibly be made in early 1987.

The assumption of an inflation rate of 5 percent for the next five years was the result of the working hypothesis of the World Economic Outlook for manufactured goods in countries exporting to Togo, the staff representative explained.

Regarding the usefulness of resident representatives from both the World Bank and the Fund, the staff had found that in the situation of Togo the amount of work in each specialized field justified their assignments, the staff representative from the African Department noted.

With respect to future growth sectors, past trends showed that there had been an increase in the contribution to GDP of the primary and tertiary sectors while the contribution of the secondary sector had declined--a reflection of the closure of the clinker plant (CIMAO) and the stagnation of the contribution of the phosphate mining company, the staff representative observed. Those trends were expected to continue along with the stagnation in industrial divestiture. As a consequence, Togo should concentrate on those sectors where growth and suitability were indicated. The weaknesses in financial management--as shown in the buildup of arrears--had led to a timetable for transfers by OPAT and OTP to the Treasury so that the necessary debt payments could be made on time. In addition, considerable technical assistance had been extended to the National Investment Fund (FNI), which was responsible for debt payments.

The staff representative from the World Bank pointed out that the Ministry for the Reform of State Enterprises had been created in September 1984 with a mandate to close, privatize, or rehabilitate state enterprises, retaining only those with portfolios considered of strategic importance. With that mandate, the Minister had immediately proceeded to audit all the firms that had been selected for the first phase of privatization and to compile an inventory of all enterprises. The first phase, in 1985, had involved 9 enterprises; in addition, the oil refinery and the steel mill had been leased to private companies and were operated as private enterprises. Subsequently, 2 more enterprises had been leased--an agricultural machinery plant and a dairy processing plant. Currently under active negotiation were enterprises involving textiles, plastics, vegetable oil processing, marble, and detergents. The remaining enterprises were OPAT, which would stay in the public sector but would be financially restructured and improved managerially, and TOGOFRUIT, which was awaiting action.

In 1986, the Government had selected 12 more enterprises--some of which had been closed before 1985--for privatization or leasing to the private sector, the staff representative continued. Those discussions, as well as audits of 23 other firms, were under way, and the authorities hoped to privatize 12-13 enterprises in 1987. The process was systematic but difficult, and the authorities had proceeded with vigor, determination, and skill.

The World Bank had provided technical assistance to the new Ministry of State Enterprises in restructuring and privatizing, the staff representative said. The Bank was undertaking a major study of the incentives with particular emphasis on the levels of effective protection for the promotion of small-scale enterprises. In addition, in conjunction with the Fund, the Bank would look at the banking system to see how the banks could be made more amenable to lending to enterprises in Togo. Currently under way was a joint study by the Bank and Fund on the fiscal situation and on how agricultural taxation could be replaced over the longer run; on the implications of tax changes for incentives to produce more exports and to compete against imports; and on ascertaining that a system did not disfavor Togo versus Benin, as they were essentially both transit trade countries.

Under the structural adjustment program, the Bank had reviewed the composition of the public investment program, the staff representative from the World Bank pointed out. In the case of Togo, the Bank was considering a second tranche under the current structural adjustment program for 1986-88. The 1986 program had been largely satisfactory, and the Bank had informed the Fund accordingly. Currently the Government and the Bank were discussing the 1987/88 program, and no major problems had been encountered.

Mr. Doe noted that Executive Directors had recognized that the Togolese authorities had made major efforts to reduce the economic and financial imbalances of the country, and they had particularly mentioned the restoration of growth, the decrease in the fiscal and external deficits, the improvements in expenditure control and debt management, and the restructuring of the public enterprise sector. Nevertheless, Directors had stated that further achievements were needed in the areas of tax administration, investment planning and implementation, agricultural policies, and public enterprises. But the wage situation of the Togolese civil servants merited attention. The previous salary increase in the civil service had taken place in January 1982, with a subsequent wage and promotion freeze. It would soon be five years since that general salary adjustment, which had amounted to only 5 percent. In addition, since January 1983, a 5 percent solidarity tax had been imposed on the alaready low salaries. To illustrate, a high school teacher and a medical doctor hired by the Government in 1982 had been earning since that time a monthly salary of CFAF 56,000 or about $160 and CFAF 97,000 or approximately $277, respectively. Over the period 1982-85, however, inflation, as measured by the cumulative rise in the GDP deflator, had exceeded 20 percent. Under those circumstances, without negating the need to maintain fiscal discipline, it was unrealistic to believe that civil service morale and productivity would be enhanced if such an erosion of purchasing power continued.

The staff had stated that under certain conditions, Togo would no longer need Fund financial assistance beyond 1988, Mr. Doe noted. As several Directors had pointed out, the performance of the Togolese economy was very dependent upon exogenous factors, such as weather conditions, export price movements, and the demand for phosphate--Togo's principal source of foreign exchange. The volume of external financial assistance also had a great deal of influence on developments in the economy. The evolution of those different factors was uncertain and beyond the control of the authorities. Therefore, while they remained committed to pursuing the adjustment efforts under way, they were not certain that the country would no longer need to use Fund ordinary or borrowed resources at the expiration of the stand-by arrangement under review. The authorities would therefore like to retain that option and would therefore not rule out a request for Fund-supported adjustment programs beyond 1987.

The Chairman made the following summing up:

Executive Directors concurred with the thrust of the views expressed in the staff appraisal and commended the Togolese authorities for the continued progress made in 1985 toward economic and financial viability. The recent revival of economic activity was particularly welcomed. Directors also noted with satisfaction the further reduction in the overall fiscal deficit, including grants, to 1.5 percent of GDP in 1985, while the rate of domestic credit expansion remained modest. At the same time, the external current account deficit, at 6.4 percent of GDP, remained significantly below the level programmed for 1985. Directors welcomed the decline in external public debt from 120 percent of GDP in 1984 to 104 percent in 1985, and the further improvement in the profile of that debt.

Directors emphasized, however, that notwithstanding the comprehensive adjustment effort that Togo has sustained under three annual economic and financial programs, from 1983 through 1985, the country still faces significant structural and financial problems. In particular, the economy remains vulnerable to changes in the world market prices of its major export products--phosphate rock, coffee, cocoa, and cotton--and the public enterprise sector requires further streamlining, while debt service continues to weigh heavily on the budget and the balance of payments. In view of these problems, Directors considered it essential for the authorities to fully implement their adjustment policies for 1986-87 and the medium term.

The authorities' program for 1986-87 rightly placed the major emphasis on a continuation of fiscal adjustment, Directors considered; they welcomed the projected limitation of the overall fiscal deficit to 1.9 percent of GDP in 1986 and 1 percent in 1987. While Directors noted with satisfaction the increase in tax revenue in 1985, they expressed concern about the difficulties experienced by the authorities in the implementation of the new tax code. They urged the authorities to improve tax administration and to raise the elasticity of the tax system.

Directors attached importance to the implementation of policies to encourage the private sector and to facilitate the financing of private productive investment by the banking system.

The authorities were commended on the recent actions already taken to lift monopolies and to liberalize the export of cereals, which should assist in expanding domestic production as well as in furthering diversification of private commerce. Directors urged the continuation of these actions. The pursuit of realistic producer pricing policies in agriculture was praised. Directors emphasized the need for the World Bank to continue to assist the authorities in carrying out the necessary further structural adjustments in the agricultural, small enterprise, and other sectors. In the regard, they commended the achievements of the authorities under the second structural adjustment program supported by the World Bank.

The Togolese authorities' implementation of a prudent expenditure policy, including restraint in wages over the past few years, while maintaining capital outlays at levels consistent with the availability of appropriate financing, was praiseworthy, Directors said. They also welcomed the authorities' intention to further reduce domestic payments arrears in 1986 and to avoid any new accumulation of external or domestic arrears. They stressed the need for prudent external borrowing to enable further reductions in the debt-servicing burden, which remained extremely high. In this context, Directors welcomed the Togolese authorities' decision to forgo a request for external debt rescheduling. Directors noted that in the period ahead Togo would require the continued concessional assistance of foreign donors, in addition to domestic adjustment.

Directors welcomed Togo's medium-term program of action, which had been developed in close collaboration with the Fund and the World Bank and which incorporated a medium-term policy framework that could be useful in connection with Togo's future access to the resources of the structural adjustment facility. Directors considered that the 1986-87 program and the medium-term policy orientation of the authorities would help Togo to achieve sustainable economic growth and enable it to meet its obligations without new debt rescheduling. It is expected that the next Article IV consultation with Togo will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

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

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

Decision No. 8301-(86/95), adopted
June 9, 1986

Stand-By Arrangement

1. The Government of Togo has requested a stand-by arrangement in an amount equivalent to SDR 23.04 million for a period of 22 months from June 9, 1986 to April 8, 1988.

2. The Fund approves the stand-by arrangement set forth in EBS/86/103, Supplement 2.

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

Decision No. 8302-(86/95), adopted
June 9, 1986

3. STAFF COMPENSATION - 1986 ADJUSTMENT

At the Chairman's invitation, Executive Directors considered, in restricted session, a Staff Association Committee memorandum on the 1986 Compensation Review, which had been circulated as EBAP/86/129 (6/2/86).

Following a brief discussion, the Chairman noted that the sense of the meeting was that the Executive Board would not want to take up the salary issue again in the immediate future. The study on the administrative tribunal would be made and circulated to Executive Directors upon completion, when further action would be considered. He would inform the Staff Association Committee accordingly.

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

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/94 (6/9/86) and EBM/86/95 (6/9/86).

4. ADMINISTRATIVE BUDGET, FY 1986 - ACTUAL EXPENSES AND TRANSFER OF APPROPRIATIONS

The Executive Board approves the report on actual expenses in FY 1986 and the proposal for a transfer of appropriations, as set forth in the memorandum attached to EBAP/86/131 (6/4/86).

Adopted June 9, 1986

APPROVED: February 27, 1987

JOSEPH W. LANG, JR.
Acting Secretary