

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/161

10:00 a.m., September 22, 1986

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

Executive Directors

Alternate Executive Directors

M. Finaish
H. Fujino
G. Grosche
Huang F.
J. E. Ismael

Mawakani Samba
A. R. Ismael, Temporary
M. K. Bush
M. Lundsager, Temporary
G. Ercel, Temporary

M. Sugita

Jaafar A.
J. R. N. Almeida, Temporary
M. Foot
H. Fugmann
L. Leonard
W. N. Engert, Temporary
J. A. K. Munthali, Temporary
C. A. Salinas, Temporary
J. E. Suraisry
J. de la Herrán, Temporary
S. de Forges
J. de Beaufort Wijnholds

J. J. Polak
C. R. Rye
G. Salehkhoul
A. K. Sengupta
S. Zecchini

O. Kabba j

F. Di Mauro, Temporary

L. Van Houtven, Secretary
J. K. Bungay, Assistant

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Also Present

IBRD: S. Bose, Eastern and Southern Africa Regional Office;
P. M. Landell-Mills, Western Africa Regional Office. African Department:
A. D. Ouattara, Director; R. J. Bhatia, Deputy Director, J. Artus,
A. Bourhane, S. E. Cronquist, Y. Fassassi, J. M. Jiménez, H. Oloyede,
E. Sacerdoti, D. J. Scheuer. Exchange and Trade Relations Department:
W. A. Beveridge, Deputy Director; S. M. Huh, S. Kanesa-Thasan,
V. P. G. Schoofs. IMF Institute: S. O. Mouhamdi, Participant. Legal
Department: J. M. Ogoola. Research Department: W. C. Hood, Economic
Counsellor and Director. Secretary's Department: J. W. Lang, Jr.,
Deputy Secretary. Treasurer's Department: J. E. Blalock, D. V. Pritchett.
Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate
Director. Personal Assistant to the Managing Director: R. M. G. Brown.
Advisors to Executive Directors: W.-R. Bengs, M. B. Chatah, L. K. Doe,
L. P. Ebrill, S. Ganjarerndee, G. D. Hodgson, K. Murakami, A. Ouanes,
M. Z. M. Qureshi, A. Vasudevan. Assistants to Executive Directors:
O. S.-M. Bethel, R. Fox, Z. b. Ismail, S. King, T. Morita, R. Msadek,
W. K. Parmena, V. Rousset, S. Simonsen, G. Schurr.

1. SOMALIA - 1986 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT - REVIEW AND WAIVER OF PERFORMANCE CRITERION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Somalia (SM/86/225, 8/27/86; and Cor. 1, 9/8/86), together with the staff report on the final review under the stand-by arrangement for Somalia for the period February 22, 1985-September 30, 1986, and a request for a waiver of a performance criterion (EBS/86/217, 9/16/86). They also had before them a report on recent economic developments in Somalia (SM/86/234, 9/10/86).

Mr. Finaish made the following statement:

In order to put economic developments in Somalia over the past year and its performance under the current stand-by arrangement in perspective, it is important that the following considerations be kept in mind.

When the authorities embarked on the 1985 Fund-supported adjustment program, the Somali economy was facing an extremely difficult situation. A combination of unfavorable exogenous developments in 1983-84, including the loss of the main market for cattle exports, had led to a sharp decline in growth and imports and thus also in government revenue. As a result, the fiscal deficit rose sharply, the rate of inflation accelerated, foreign exchange reserves were depleted and external arrears began to accumulate. It is true that the policy response was not rapid enough to redress the situation, but the difficulty of dealing with the sharp decline in export earnings (27 percent in 1983 and 38 percent in 1984) and its impact on the economy should not be underestimated.

The economic program for 1985 was conceived as only the first phase of a medium-term recovery plan. Nevertheless, the objectives set by the authorities for the year were quite ambitious and the policies designed to achieve those objectives were fairly comprehensive, covering a wide range of structural and financial measures. Moreover, as Directors may recall, most of the important policy measures under the 1985 stand-by arrangement were in the form of prior actions, including the elimination of most trade restrictions and price controls, and a substantial liberalization of the exchange system combined with a large depreciation of the official exchange rate.

When the 1985 program was formulated, it was recognized that the depleted foreign exchange reserves and the magnitude of the imbalances in the economy left the authorities with almost no room for maneuver in case the program assumptions did not materialize. In particular, the external payments situation hinged critically on foreign exchange inflows from creditors and donors being available to Somalia in a timely fashion.

Major cash flow problems were encountered in 1985 and early 1986, as pledged external assistance was not disbursed as scheduled. These difficulties were compounded by the sharp decline in workers, remittances, amounting to about \$40 million, as a result of declining employment opportunities in the neighboring oil exporting countries. This factor alone more than offset the 50 percent increase in exports which was achieved in 1985. The consequent drop in imports, and thus in import duties, was a major factor behind the shortfall in government revenue. This revenue shortfall--along with higher expenditures resulting, among other things, from higher than programmed external debt service payments--made it extremely difficult to remain within the programmed deficit target.

Under these circumstances, it was decided to extend the program in order to put together the necessary policy measures for the achievement of the program targets, albeit over a longer period. This extension not only helped preserve the continuity and momentum of Somalia's adjustment efforts but was also a good example of the flexibility that is needed on the part of the Fund when the authorities show a clear willingness to cooperate in implementing needed adjustment policies, as has been the case with Somalia.

Most of the structural measures designed to improve resource allocation and growth, such as pricing, marketing and exchange liberalization, were implemented in the early part of the program. These measures have already had a positive impact on the growth and export performance. The authorities have since then been taking additional steps to promote private sector activity, particularly in agriculture and industry. In stepping up agricultural reform, which constitutes an important part of the current public investment program, the authorities are cooperating closely with the World Bank. Moreover, in order to stimulate livestock production, private sector livestock exporting cooperatives are being encouraged. Similarly, in the case of manufacturing, a more active private sector participation is being sought. Toward that end, a revised private and foreign investment law has been prepared and is expected to be considered by the Council of Ministers in the near future.

The reorganization of public enterprises continues to be a matter of priority, although actual progress in this area may not have been as fast as one would have liked. As in other countries where public enterprises constitute an important part of the economic structure, a comprehensive reorganization inevitably faces many obstacles and cannot, therefore, be achieved over a short period. For example, the attempt to privatize certain public enterprises in Somalia has been difficult because of the capital and managerial limitations of the private sector. In those cases, the authorities have found it easier to contract foreign management.

A number of other enterprises that were considered unviable have been shut down. Close cooperation is being maintained with the World Bank in forging ahead with public enterprise reform.

An important element of the 1986 program is to improve the tax structure and strengthen revenue collection. Measures taken in this regard include the conversion of certain specific taxes to an ad valorem basis, an increase in the coverage of excise taxes, the use of a more depreciated exchange rate for import duties, and a number of administrative improvements in tax collection.

With respect to financial sector adjustments, the authorities moved early in 1986 to raise interest rates in line with expected inflation at that time. More recently, as inflation did not drop as projected, the interest rate structure was again raised by 4 percentage points in two steps retroactive to August 1 and September 1, 1986. While adjustments have thus been made in interest rates, the authorities are of the view that the degree of flexibility allowed in interest rates needs to take into account the low interest elasticity of financial savings in Somalia and the need to encourage private sector investment. Regarding institutional reform in the banking sector, the management and operations of the commercial bank have continued to be strengthened in 1986. In order to improve efficiency and competition in the banking sector, a law permitting the formation of private commercial banks has been prepared, and the authorities are confident that it will soon be approved.

The aforesaid tax measures have already had a significant effect on fiscal revenues. In the second quarter of 1986, collections were 72 percent higher than in the first quarter and 175 percent higher than in the second quarter of 1985. For the year as a whole, it is now estimated that the targeted increase in revenues--excluding grants--of 59 percent will be more than met. However, in the light of the shortfall in grants, the authorities have recently moved to reduce expenditures further in order to compensate for that shortfall. In addition to a 5 percent across-the-board reduction in expenditures, ministries and departments that exceeded their budgetary allocations in the first half of 1986 will have their allocations for the second half reduced by an equal amount. Furthermore, the Government will review budgetary developments on a monthly basis in order to take additional measures, if necessary, to meet the budgetary and domestic credit targets of the program.

Monetary developments so far in 1986 indicate a significant tightening relative to 1985. The additional fiscal measures taken recently should enable the authorities to stay within the 8 percent limit for net domestic credit expansion. Although the April limit for credit to the Government was exceeded, this breach of the target was of a technical nature, as explained by the staff.

For 1986 as a whole, it is now expected that broad money, excluding counterpart fund deposits and foreign currency deposits, will grow by only 12.4 percent compared with 45.6 percent in 1985.

The authorities are continuing their efforts to diversify exports and to find new markets for cattle exports. Over the last two years some success has been achieved in finding alternative markets for cattle, as indicated by the increase in livestock exports in 1985 and 1986. However, other exports have not risen significantly, partly because measures taken to increase incentives, including the new exchange arrangements, have not yet had their full effect. Total export earnings in U.S. dollars in 1986 are now expected to fall significantly short of the level targeted in the program. Similarly, imports are now projected to be significantly lower than the program target. As a result, the current account deficit--excluding grants--is estimated to be 9.7 percent of GDP, compared with the 11.8 percent programmed for the year.

The agreed monthly adjustments in the official exchange rate have continued to be implemented. The authorities remain committed to the unification of the exchange rate by the end of 1986. The bimonthly auctions of foreign exchange resources provided by the World Bank are expected to speed up the movement toward full unification. In the next few weeks a review is expected to be held with the Bank and the Fund to determine whether the auction procedures are adequate and the objectives are being met, and to discuss further steps that may be necessary to achieve unification at a sustainable level by the end of the year. The authorities are aware that this is likely to involve a more rapid depreciation schedule for the official rate. In the meantime the free market, which accounts for the bulk of transactions, will continue operating as at present.

As the staff points out, Somalia's balance of payments will continue to be under severe pressures over the next few years. The high debt service ratio and the reduced prospects for foreign exchange earnings from exports and remittances make it critical that external assistance and debt relief be provided in adequate amounts, on appropriate terms, and in a timely fashion. As the experience of the last two years has shown, shortfalls and delays in these flows can have serious adverse effects on Somalia's adjustment efforts and its ability to avoid debt servicing problems, which in turn can lead to the interruption of other external flows. The disbursement delays that occurred in 1985 and early 1986 have clearly had a major effect on the fiscal and external payments position during that period and made it difficult for the Somali authorities to avoid the accumulation of external arrears to creditors, including the Fund. At the same time, the decline in the ability to import has had a negative effect on the growth performance. In assessing the medium-term outlook, the staff has pointed out that unless additional foreign assistance is made

available in the period ahead, Somalia will need to reduce imports further. This would be a very unfortunate development as it would make it much more difficult to achieve the medium-term growth and balance of payments objectives. The staff also points out that the outlook for the debt service position beyond 1991 will be affected importantly by the terms obtained on the debt incurred from 1986 onward. This should be fully recognized by Somalia's creditors, some of whom have requested, in the context of the rescheduling negotiations, interest rates that exceeded commercial rates in those creditors' markets.

Finally, the Somali authorities wish to assure the Board of their determination to remain current in their financial obligations to the Fund. The nature of the cash flow difficulties that led to the emergence of arrears to the Fund over the last two years are explained in the staff report. In order to avoid such problems in the future, the authorities are working on an improved cash flow projection and management system. Furthermore, various cash receipts are being earmarked to facilitate payments to the Fund. The authorities continue to give Somalia's obligations to the Fund a special priority. They also consider the role of the Fund in supporting Somalia's medium-term adjustment effort to be a crucial one. It is their expectation that discussions on a follow-up stand-by arrangement as well as on an arrangement under the structural adjustment facility will be completed successfully in the near future.

Mr. Suraisry made the following statement:

I am pleased to see that Somalia has now become current with the Fund. The staff report brings out clearly the seriousness of the financial problems confronting the country. The magnitude of the external imbalances is such that strong and sustained adjustment efforts will not be sufficient in themselves, particularly if the momentum for growth is to be maintained. They should also be complemented by sufficient financial assistance and adequate debt relief. Perhaps as important as the size of foreign assistance is, its timely disbursement, particularly because Somalia's foreign reserves have been virtually depleted. It is therefore crucial that donors as well as the authorities work together to ensure the availability of financial resources in a timely fashion. For their part, the authorities should avoid delays in meeting the conditions for the various assistance agreements. Donors, for their part, need to be more aware that delays in disbursements, and uncertainties concerning the timing of the assistance flows, do have an adverse impact.

The authorities have introduced new measures in the 1986 program that have strengthened the policy package and will ensure that the objectives established in the program are broadly met.

A combination of excellent weather conditions and the authorities' appropriate policies, including the strengthening of incentives, freeing of markets, and a flexible exchange rate policy, have helped stimulate agricultural output. As a result, real GDP is expected to grow in 1986 by 5 percent, exceeding the program's initial target of 4.5 percent. I was particularly impressed to read in the letter of intent that as a result of a record agricultural output in 1986, Somalia is now expected to have surpluses in both maize and sorghum.

While all fiscal policies agreed upon under the program were implemented, the overall fiscal deficit is expected to be 5.7 percent of GDP, compared with the 5 percent targeted under the program. The larger than programmed expansion in the fiscal area is to a large extent due to the shortfall in grants. The overall deficit, excluding grants, will actually be much lower than that envisaged under the program. This is a result of a commendable improvement in revenue collection, a more stringent control of expenditures, and a commitment not to grant a generalized wage increase in 1986. However, it is essential for the authorities to achieve their fiscal objectives for 1986, particularly in view of the lack of progress made so far on the inflation front.

I welcome the recent strengthening in monetary policy, and the intention of the authorities to guarantee a minimum level of credit to the private sector. This is essential if the private sector is to accelerate its participation in economic activity. Since the nonobservance of the performance criterion on net credit to the Government for end-April was due to a technical reason, and sufficient resources were indeed available, I support the request for the waiver.

It is clear that the balance of payments position will remain difficult in the medium term and will require a redoubling of Somalia's efforts to improve the level of its foreign exchange earnings, as well as substantial foreign assistance. The authorities have made progress by liberalizing the exchange and trade systems, and more recently, by reiterating their commitment to the unification of the exchange rate markets by end-1986. It is hoped that such a unification will provide an adequate incentive to exporters, improve the allocation of resources, and eliminate the need for export surrender requirements. In this context, I welcome the recently launched auction system, as this will provide a proper avenue for carrying out the unification of the exchange markets.

The continuing difficulties that are foreseen in the balance of payments have regrettably led the Somali authorities to reduce the target for the elimination of net external arrears. I hope that if additional resources become available, the authorities will give the payment of arrears the highest priority. It is clear from the letter of intent that the authorities are aiming for a tightening in their adjustment efforts. I welcome this, since

perseverance in the adjustment effort will be required if Somalia is to attain a viable balance of payments position in the medium term.

A sentence in the staff report (SM/86/225, 8/27/86, page 4) refers to the Saudi Arabian ban on imports of cattle from Somalia in a one-sided, unbalanced way. As it stands, the sentence blames Saudi Arabia, directly or indirectly, for the continued imbalances in the external sector of Somalia. No reference was made to the new markets that Somalia has found, although that point is made by the staff later in the report. Moreover, the sentence did not even mention the reasons behind the ban, even though we have explained those reasons to the staff bilaterally and at the Executive Board on past occasions. Since we have explained those reasons, I will only repeat that we encountered health problems from those cattle; that Somalia is not the only country whose cattle have been banned; and that once my authorities are satisfied that those cattle will pose no health problems, we will lift the ban. As a matter of fact, the ban on sheep was lifted a few years ago, and Saudi Arabia now constitutes a large market for sheep from Somalia. I strongly urge the staff to be careful in writing about something that touches upon the relationships between members. For the record, let me say that the relationship between Saudi Arabia and Somalia has been and still is outstanding, and the ban on cattle was not intended at all to hurt Somalia. Saudi Arabia has been and will continue to be very helpful to Somalia. Finally, I endorse the proposed decisions.

Mr. Zecchini made the following statement:

We welcome the fact that once again Somalia has been able to clear its arrears to the Fund, making it possible to proceed to the last review under the current stand-by arrangement. Before commenting briefly on the recent economic policies and developments, I would like to say a few words on future prospects and on the complementary action that may be played by the Somali authorities, the Fund, and the donor countries.

According to the medium-term outlook in EBS/86/217 (9/16/86, page 10), "developments in the current program indicate that the authorities should be aiming for a significant tightening of the adjustment effort in the coming years, if a sustainable balance of payments is to be attained within a reasonable period of time." In our view, prudent financial policies are essential but should be accompanied by structural reforms, such as the establishment of a unified freely floating exchange rate, further improvements in price policies, incentives for production, and the rehabilitation of public sector enterprises. A program under the structural adjustment facility, with the collaboration of the World Bank, could provide a useful framework for such adjustment efforts.

However, we have not found any indications in the staff report on the forms of collaboration between the Fund and Somalia that might be expected when this stand-by arrangement expires, and we wonder whether the staff could elaborate on this issue.

As stressed in the report, additional donor support for Somalia's adjustment efforts will be needed in the coming years. In the light of past difficulties, efforts should be made by all parties concerned to allow for timely disbursement of aid. Some delays have also occurred in finalizing bilateral agreements connected with the 1985 Paris Club rescheduling, owing to negotiations on interest costs. In this respect, I was surprised to read (SM/86/225, 8/27/86, page 12) that the interest rates requested by official creditors had sometimes exceeded the then current commercial rate in donor countries.

As for recent economic policies, performance under the program has been mixed. It is encouraging to note that some of the main objectives under the stand-by arrangement have been reached with comfortable margins and that growth in 1986 is projected at 5 percent and the current account deficit, at \$130 million. However, even though financial policies have been tightened after the occurrence of slippages in 1985, efforts in this area might have lacked the desired strength. The staff admits candidly that with the benefit of hindsight, some of the assumptions made in designing this program have proved too optimistic (SM/86/225, 8/27/86, page 27), and that for 1986 a smaller overall budgetary deficit with a greater improvement in the Government's position with the banking system would have been more appropriate.

On a more positive note, successful efforts have been made in reducing public sector current expenditures, thereby leaving more room for an increase in public investment expenditure. Moreover, some important changes have been made in the tax system and in administrative procedures in order to improve revenue collection. On a related issue, the authorities intend to reform the civil service and to improve its efficiency by increasing wages and attracting more qualified personnel. While we share the authorities' view, its cost implications lead us to believe that this process will have to be combined with reductions in the total number of government employees.

As for external policies, important, albeit partial, progress has been achieved toward the attainment of a unified floating exchange rate. Despite the adjustments that have been made in depreciating the official rate, it and the free-market rate have not converged, suggesting that a faster pace of depreciation in the official rate is desirable if unification is to be reached by the end of the year. A depreciation of the official exchange rate toward market-oriented levels would also enhance incentives to export, as this rate is applied to the 50 percent export surrender

requirement. Moreover, as stressed repeatedly by the staff, Somalia's export perspectives could be enhanced considerably if it were possible to restore better access to some foreign markets. We welcome the recent institution of the auction market for foreign exchange and we believe that it might provide an appropriate framework for the unification of foreign exchange markets.

Mr. Grosche made the following statement:

The authorities have settled their overdue obligations with the Fund and intend to earmark resources to ensure that upcoming payment obligations will be met on a timely basis. This development is very much to be welcomed. I wish that I could comment as favorably on policy performance. Some progress was made, in particular with respect to the liberalization of the economy, and the growth objective for 1986 will be exceeded. However, developments in other areas were quite disappointing.

In particular, fiscal and monetary policies in 1985 were more expansionary than planned. I acknowledge that factors beyond the authorities' control--particularly the delays in the flow of foreign assistance--contributed to the disappointing outcome, but the non-implementation of several policy measures was also a major reason. This is regrettable, the more so since strict adherence to the adjustment program was called for in view of the continuing serious situation of Somalia's economy.

It is heartening to note, therefore, that the authorities have recently approved a number of measures in the fiscal and monetary areas to strengthen the adjustment effort. In fact, there are improved prospects that the objectives established in the program can be broadly met. Still, some worrisome deviations are expected to occur, in particular with regard to the inflation target. I am also concerned that the balance of payments outlook for the medium term has worsened. Somalia will continue to need substantial donor assistance and debt relief to cover the projected financing gaps. In view of this difficult external situation, I fully endorse the staff's statement that a redoubling of Somalia's adjustment efforts is required. This implies not only a tightening of demand-management policies, but also a strengthened effort to increase the export potential of the country.

I believe that there is still considerable scope for generating more exports. The Government has been successful in finding new markets for cattle, and efforts to look for alternative markets are being undertaken. These efforts should be continued. Nevertheless, it is disappointing to note that exports other than livestock have been stagnant.

An appropriate exchange rate policy will be crucial. The authorities have continued with the monthly depreciation of the official rate. However, I join Mr. Zecchini in believing that a faster depreciation would be useful in the context of the envisaged unification of the exchange system. Progress in this area has been rather slow, and the difference between the official and the market rates continues to be great. If the program target of unifying the exchange rate by the end of this year is to be met, a stronger correction of the official rate is clearly called for.

In concluding, I can support the proposed decision, including the requested waiver for the nonobservance of the performance criterion on net credit to the Government for April 1986. Like the staff, I believe that the nonobservance of this ceiling was inadvertent.

Mr. Foot made the following statement:

I join previous speakers in welcoming the clearance of Somalia's overdue obligations to the Fund, which has made today's review possible. The intense effort to this end of all those involved, particularly the Fund staff, is to be commended. Somalia has had severe difficulties servicing its debt on time for a considerable period. I welcome the authorities' intention to earmark foreign exchange for forthcoming obligations to the Fund, and donors' intentions to smooth out and increase the flow of their own aid. The authorities must ensure that they do not exacerbate the problem with unnecessary delays in fulfilling donors' documentation needs, because this can be a source of great frustration for both the authorities and the donors.

In some respects, the economic performance in 1986 has turned out better than expected at the April 1986 review: growth is a little higher, and the current account and overall balance of payments deficits are slightly lower. The authorities' actions to improve revenue collection have been successful, and together with the recent package of expenditure cuts, the government deficit should be slightly narrower than expected in April, which is welcome indeed, given the overrun last year.

It will be important to build on these latest measures with a further strengthening of the authorities' adjustment efforts. It is clear that more remains to be done. The staff has listed a number of tax changes under consideration designed to improve revenues and efficiency, including the use of the free-market exchange rate as a basis for charging import duties--but it is regrettable that this change has been delayed further; a restructuring of import duties; and adjustments in the sales, excise, and income taxes. Further improvements in tax administration are also essential. On the expenditure side, the decision not to grant a

generalized wage increase this year is helpful, but I note that in the context of the intended reform of the civil service, some major wage increases are felt to be necessary. I would very much endorse Mr. Zecchini's remarks on the need for caution on this point.

The authorities have begun welcome discussions with the World Bank on the reform of the public enterprises, including privatization and increased foreign participation. On a more general note, there seems to be a need to reduce impediments to both foreign and private investment.

In the area of monetary policy, the recent increase in interest rates is welcome, as is the authorities' intention to keep those rates under review in the light of developments in inflation. I would also urge the authorities to speed up the legislation that will allow more competition in the commercial banking sector. Many of the above-mentioned reforms could well be the focus of an arrangement under the structural adjustment facility, and I would be interested in staff comment on the prospects for such an arrangement.

With respect to external policy, the authorities' initiation of an auction system at the beginning of September 1986 is a positive move toward the goal of exchange rate unification by end-1986. However, I concur with previous speakers that it is disappointing that faster progress has not been made in adjusting the official rate to the free-market rate, and that the rate of depreciation of the former has only slightly outpaced the depreciation of the market rate since March 1986. I would be interested in staff comment on what additional steps seem necessary to prepare the way for unification of the exchange rate on the planned timetable.

I can go along with the proposed waiver, as I would agree with Mr. Grosche that the failure to transfer funds to the Central Bank, which caused the April breach of performance criteria, was technical in nature. However, it is another reflection of the administrative weaknesses that have been a major cause of the difficulties of this program. The staff has remarked frankly that with hindsight, such problems might have been anticipated, given the inadequate statistical base and reporting system, which has often made policy corrections difficult to formulate and implement, and given the uncertainties about the impact of certain instruments on final objectives. Although improvements have been made in policy formulation and implementation and in fiscal administration, serious shortcomings remain, and they have important implications for the nature of any follow-on program. Technical assistance will probably have an important role to play here. Nothing in the staff report suggests that anything imminent is planned, and I would be interested in staff comment on what, if anything, is

intended in the foreseeable future. I agree with Mr. Zecchini that there is a need to address future relations between the Fund and Somalia; in particular, if there is to be another stand-by arrangement, the appropriate level of access is a subject that will require attention. In conclusion, I can endorse today's decisions.

Mr. Engert made the following statement:

I support the proposed decisions, and as I agree generally with the staff's analysis, I would encourage the authorities to pay close attention to the recommendations that have been made.

In the area of resource allocation, I was pleased to note the deregulation and liberalization of arrangements in the agricultural sector, and I would encourage the authorities to continue to strengthen these efforts. Similarly, in the industrial sector, I agree with the Government's intentions to encourage additional private sector activity. However, I note that a substantial portion of the industrial sector remains in the Government's hands, although I am encouraged to note that a reorganization of the sector continues to be a high government priority. I welcome the role of the World Bank in the review of public enterprises in Somalia.

An important complement to liberalization and deregulation in the agricultural and industrial sectors would be greater liberalization in the financial sphere, and I was encouraged that the authorities are quite close to introducing a law allowing the formation of private commercial banks in Somalia. I was also pleased to note that several foreign and domestic concerns have expressed interest in forming a new bank in Somalia.

Monetary policy has been strengthened by the recent increase in interest rates. However, to the extent that interest rates are negative in real terms, the positive effect of an interest rate policy is not likely to appear, and thus interest rates should be increased further and should be kept under review in the light of the trends in inflation. In this connection, I would like to stress that by keeping interest rates below market clearing levels, the effective constraint on investment is a lack of savings. Moving closer to what might be market clearing levels, notwithstanding the imperfections of Somalia's developing financial system, would tend to increase both savings and investment. In addition, I encourage the authorities to move away from direct credit controls and allocation, and to rely more on market incentives. The planned liberalization in the banking sector should facilitate this.

Unifying the exchange system is an exceedingly important objective for Somalia. This would complement and strengthen liberalization and deregulation measures and help make the

difficult external situation more manageable. I am encouraged by the steps that the authorities have taken in this direction, but the difference between the free-market rate and the official rate continues to be large, and a faster depreciation of the official exchange rate would be helpful, as would an adjustment of the commercial rate to the free-market rate. Moreover, the recently launched auction system will provide a proper avenue through which to carry out unification of the exchange rate system, and I would encourage the authorities to move quickly to accomplish this objective, and certainly by no later than end-1986.

Finally, I thank the Somali authorities for their efforts in becoming current with the Fund. It is important, not only to Somalia but to all members of the Fund, for Somalia to remain current, and I welcome the efforts of the staff and the authorities to develop arrangements to ensure that all coming obligations to the Fund are settled as they fall due.

Ms. Lundsager made the following statement:

Somalia's present stand-by arrangement continues with a number of difficulties, particularly because the sharp increase in exports since 1984 is being offset by the large drop in remittances--although overall, the payments position is improving. Furthermore, immediately after we completed the first review in May 1986, Somalia once again incurred arrears to the Fund, and has only recently eliminated those arrears. Of course, we very much welcome this elimination of arrears. We are aware of the tight foreign exchange situation facing the authorities, but are nonetheless most discouraged by this recurrence of arrears. Thus, it is somewhat reassuring to note that the authorities intend to earmark external resources for debt service to the Fund. In that regard, we believe that it is important for donors to support Somalia with the appropriate form of assistance so that they can meet their external obligations. My own authorities have made such efforts, especially in support of the exchange market reforms.

The authorities are making substantial efforts to attain the program goals this year, and we welcome, in particular, the additional expenditure measures aimed at offsetting some overruns that had occurred in the first half of the year in some departments. The net result is that expenditures are expected to be slightly less than programmed. Furthermore, since the rate of inflation has been higher than expected, expenditures are dropping in proportion to GDP, from 19.5 percent to 17.3 percent. The authorities are planning some tax measures, and in the light of the low ratio of revenues to GDP--barely over 5 percent--we can support such efforts. However, we would urge the authorities to place particular emphasis on preserving and strengthening incentives in any reformulation of the tax system, with particular emphasis on reducing

dependence on trade-related taxes. In that regard, technical assistance from the Fiscal Affairs Department could perhaps prove useful. In addition, we welcome the authorities' commitment to civil service reform.

Despite these additional measures, the situation in Somalia will continue to be tight. External arrears will not be reduced as much as had been hoped. A large financing gap is still projected for this year, but it is expected to be closed by rescheduling later in the year. Because of these large-scale difficulties, we place particular emphasis on a number of structural adjustments that are needed to strengthen Somalia's medium-term outlook.

It is critical for the authorities to achieve the long-planned unification of the exchange markets this year. The authorities have decided to unify through an auction system, instead of the free-market system that we had thought was functioning fairly smoothly, especially since the exchange and trade system and domestic prices had been substantially liberalized in 1985. We would appreciate any clarification that could be provided on this change of approach and any details that the staff has as to the functioning of this new system. Our main concern is that the divergence between the official rate and the free-market rate was over 100 percent recently, and this appears to be a wide gap to close with a depreciation of the official rate of just 4 percent a month. At the end of the year, there will obviously have to be some additional steps. We are specific on the foreign exchange market because our understanding is that Somalia has a largely viable private sector that should be encouraged to produce for export, as well as for domestic consumption, but that entails maintaining competitiveness through appropriate exchange rate adjustments, which the free market had appeared to be doing.

In that regard, I have several questions. Workers' remittances have dropped quite steeply, and I wonder whether the staff has any information that might indicate whether that is due fully to workers returning from abroad or to other matters, since there has been such a sharp drop. I would also like to know whether staff has any theories as to why the private sector has accumulated large deposits of foreign exchange at the commercial bank because the reason for this occurrence was unclear. Finally, at our review in May, we had raised some questions regarding the 50 percent export surrender requirement, which in combination with the export tax, appeared to be a substantial disincentive to exporters. At that time, we had been reassured that the large depreciation had benefited exporters and that their profits were still much higher and incentives for export were strong. Any update of that information would be welcome, especially in the light of the higher than expected domestic rate of inflation.

Other efforts to improve the efficiency of utilization of Somalia's limited resource base are also necessary to strengthen the medium-term outlook. In that regard, the long-awaited program to rehabilitate the public enterprise sector merits strong support, and we would appreciate an update from the World Bank representative on the study due for completion soon. Given Somalia's location, we still think that it could be an attractive foreign investment locale. We recognize that such investment will probably not occur on a grand scale, but it could be useful in supporting divestment of commercially oriented public enterprises. In that regard, we welcome Mr. Finaish's indications that a revised private and foreign investment law will be considered soon by the Council of Ministers.

One final point on structural measures relates to the banking system, currently composed of only one commercial bank. We strongly urge that efforts to broaden the scope of commercial banking in Somalia be accelerated so that intermediation can occur much more smoothly. Foreign investment could also play a useful role in this sector, as the authorities appear to recognize. We would also suggest that efforts be made to broaden the range of monetary policy tools, so that dependence on credit ceilings could be reduced.

We welcome the recent interest rate measures, but in the light of the high rate of inflation, additional efforts might be required. We also wonder whether the excess of inflation over interest rates played any role in the drop in remittances. With the difficult financial situation and the high level of external debt outstanding, we strongly urge the authorities to limit their use of Fund resources in the credit tranches. The medium-term outlook indicates that the tight situation facing the authorities and the difficulties related to servicing debt on nonconcessional terms will continue probably into the next decade. Outstanding use of Fund credit is already high, around 200 percent of quota, and it apparently has contributed to the financial difficulties facing the authorities. Financing under the structural adjustment facility would appear to be much better suited for Somalia. Finally, we would welcome any information that staff might have on Somalia's observance of the end-July performance criteria. We can support the proposed decision, noting that the waiver requested for end-April appears to be related to some inefficiencies in management, not to shortfalls in policy implementation.

Mr. Ismael made the following statement:

I welcome the payment by Somalia of its overdue obligations to the Fund and the efforts that the authorities are making to avoid such problems in the future. In addition, I am in favor of the request by the authorities for a waiver of the nonobservance of the performance criterion regarding credit to the Government.

It is noteworthy that despite the many problems facing Somalia, progress was made in certain sectors of the economy in 1986. Indications that real GDP might be stronger in 1986 than projected earlier are encouraging, as is the downward revision of the current account deficit. Although the revised projections indicate a higher rate of inflation than forecast earlier, we note that this rate will nevertheless be lower than in 1985. However, the overall economic situation is still difficult. The Government's fiscal position needs to be improved and the external debt is putting a heavy burden on the external accounts.

I welcome the strong fiscal measures taken by the authorities to strengthen control over expenditure and to improve revenue collection. The change in the way customs duties are assessed on imports, and the other administrative measures taken to reduce smuggling and tax evasion, are appropriate. All these measures will help the revenue position of the Government and, as noted by Mr. Finaish, the latest projections indicate that revenue for 1986 will exceed the original forecasts. On the expenditure side, the additional measures being put into place are welcome and should contribute to the authorities' other efforts to rein in outlays and thus meet the overall deficit target for 1986.

The measures being taken in the monetary sector are in the right direction and should help the authorities to improve their control over credit and monetary policies.

Developments in the external sector continue to be difficult in 1986. While livestock exports have increased and efforts are being made to widen the export base as well as export markets, the external account position is projected to stay under pressure in the medium term. The authorities are well aware of this situation and are taking several measures to improve it. They have already liberalized prices and markets with a view to increasing production, and are moving toward a unification of the exchange rate. However, it will take time before all these measures begin to have their full impact on the economy. In the meantime, the country is faced with an increasing external debt burden. This situation is made worse by the uncertainty associated with the disbursement of foreign financial assistance. Better coordination of the assistance program by Somalia with its donors could alleviate this problem, and I urge the authorities to give full consideration to this suggestion. However, given the overall situation of Somalia, the authorities need to continue, and even strengthen, their adjustment efforts in line with the staff's recommendations. In conclusion, I approve the proposed decisions.

Mr. Wijnholds made the following statement:

Economic performance in Somalia remains somewhat unbalanced. Growth is satisfactory, but the rate of inflation is increasing again this year and external vulnerability continues to be great. Somalia has a history of external arrears, including arrears to the Fund. While it has recently succeeded in settling its overdue obligations to the Fund--and I join others in expressing my satisfaction with this development--the chances for a renewed occurrence of arrears are substantial. In that light, I welcome Somalia's plans to earmark foreign exchange for the purpose of making timely payments to the Fund in the future.

Somalia's weak external position, with a virtual absence of foreign exchange reserves, makes it imperative for the country to continue to rely heavily on foreign donor assistance. Problems have arisen because of delays in the receipt of donor support, but this is not the only reason for Somalia's earlier underperformance under the stand-by arrangement. Despite considerable achievements stemming from structural reforms, and the introduction of market-oriented policies, the implementation of the financial program fell short in a number of areas.

In the meantime, additional measures have been taken. I particularly welcome the expenditure measures that have recently been approved, which should enable the authorities to meet the targets for expenditure and the overall deficit. There has also been a substantial increase in interest rates. However, in view of the higher than expected rate of inflation, real interest rates have remained negative and the authorities should not hesitate to increase them further if price rises do not abate.

Progress toward unification of the multiple exchange rates now in existence has not been all that encouraging, as the difference between the various rates has not narrowed. I note, however, that the authorities remain committed to unifying the rate before the end of this year and, as Mr. Finaish has stated, the authorities are aware that this is likely to entail a more rapid depreciation of the official rate.

The authorities have taken several commendable steps toward privatization of enterprises. However, it seems that the domestic private sector is not in a position to provide the required capital and management, and foreign investment could play a most useful role here. In this respect, the attempt to renew the activity of foreign banks in Somalia could play an important role. In conclusion, the authorities are making important efforts, but given their vulnerable position, they cannot afford any slippage in the implementation of the financial program.

The staff representative from the African Department said that for some time, the staff had held the opinion that the authorities needed to depreciate the exchange rate more quickly to accelerate the process of unification of the exchange market. The authorities had expressed the feeling that a substantial element of speculation was present in the free market and that the free rate did not reflect the underlying economic situation. Thus the question of how best to accomplish the unification was of considerable concern to the authorities. Moreover, the authorities had indicated that because the decision would have to be approved by the Council of Ministers, they wanted to bring the unification issue to the Council only once instead of several times. The auction system that had started in September provided an avenue for testing the market forces, and the authorities saw that as a method by which they could also demonstrate to the Council of Ministers the workings of the market forces. The initial auction, held on September 2, 1986, had resulted in an exchange rate of \$1 = So. Sh. 110, compared with a free market rate before the auction of nearly So. Sh. 157. The second auction, held later in September, had resulted in an exchange rate of \$1 = So. Sh. 100. Meanwhile, the free-market rate had dropped to a level between So. Sh. 120 and So. Sh. 130 to the dollar, which lent support to the authorities' view that there was speculation in the free market.

However, the staff was concerned that the auction rate had perhaps dropped below the correct level, the staff representative continued. In those auctions, the number of successful bids ranged between 30 and 20, so that the extent of the market was quite limited. The staff expected to discuss such issues with the authorities, including the choice of an appropriate method of bringing about the exchange rate unification, in the context of planning for a future arrangement with Somalia. It was premature to provide the Board with any scenario, as the staff still needed to discuss the possibilities with the Somali authorities. Of course, the staff would review the auction system during the forthcoming mission to ascertain that it was indeed a free system that allowed the testing of the market.

The staff had been hoping to have some suggestions from Directors on what form of assistance might be best for Somalia in the near future, the staff representative indicated. Somalia was on the list of countries eligible for an arrangement under the structural adjustment facility, and the staff hoped to conclude such an arrangement before the end of 1986. However, there was also likely to be a need for a stand-by arrangement to permit the Paris Club rescheduling that the authorities had requested.

The authorities had become quite concerned at the developments in civil service wages, the staff representative noted. In fact, it had become extremely difficult for them to retain appropriate staff because of the low wages, and most important, to obtain a full day's work from the civil servants, because they were engaging in other activities to earn an adequate living. The civil service reform, studied in conjunction with a group of donors, would provide an avenue for the

higher wages to be financed partly by a reduction in the size of the civil service. At the same time, the authorities believed that there was a need for increased activity in the private sector to provide alternative employment opportunities for the civil servants affected by the reduction in force. In that regard, it was noteworthy that part of the agrarian reform in Somalia had involved giving plots of land to civil servants to induce them to leave the civil service.

Somalia had been successful in finding alternative markets for some exports, but in order to expand the markets for livestock, some infrastructural problems needed to be remedied, the staff representative pointed out. For example, the absence of pellet feeding facilities for the animals while they were in transit precluded shipment to markets that were too distant, because the animals would arrive too depleted in weight to make it a profitable enterprise.

With respect to other minor exports, the large expansion in banana plantings would soon be reflected in export figures, the staff representative went on. Somalia also had considerable opportunities in the area of hides and skins, and that market might be privatized in the near future.

The size of the drop in workers' remittances was not fully attributable to the fall in employment opportunities in the Gulf area, the staff representative mentioned. That drop also reflected some lack of confidence among private individuals who could transfer such resources. The political situation in Somalia was still quite fluid. The change in the economic system that had been made over the past two years did not have the full support of everyone in the country, and a sense of foreboding persisted as to what might happen. That same problem of confidence explained to some degree why Somali citizens had decided to repatriate some of their funds but to keep them in dollar-denominated accounts in the commercial banks. However, it had to be noted that the rapid depreciation of the free-market rate had offered those individuals an investment alternative, because they were certainly able to earn greater returns by keeping their money in dollars for a longer period.

Although in theory one would agree with Ms. Lundsager's advice to the authorities to move away from foreign trade taxes, unfortunately the situation had to be viewed in the light of the administrative capabilities in the civil service, the staff representative noted. A sharp move in foreign trade taxes would lead to a substantial reduction in revenues. It was considerably easier for customs officials to collect foreign trade taxes than it would be to collect taxes on profits made by importers.

Final data were not available on the end-July performance criteria, but the staff had received communications from the resident representative indicating that those ceilings had been observed, the staff representative indicated.

When the Somali authorities had approached some of their creditors for bilateral rescheduling agreements, they had been surprised to find that the interest payments in some agreements were being increased to reflect more current market conditions, the staff representative from the African Department remarked. The previous arrangements had had interest subsidies included in them, but in two of the four new agreements, the interest rates exceeded by a substantial margin the rates at which the government was borrowing in the local markets. The Somali authorities had negotiated to have the interest rates reduced by a small amount, but those rates still remained quite high.

Mr. Foot commented that he had already asked his authorities to consider, in the Paris Club context, whether a program under the structural adjustment facility would not be sufficient for the Paris Club requirements.

The Chairman added that Mr. Foot had raised one of the questions that the Fund was also asking itself, and that he would appreciate guidance from the Executive Board on the matter.

The staff representative from the World Bank said that a mission had gone to Somalia in late June and July 1986 to discuss public enterprise reform efforts with the authorities. There had been general agreement that the Government should speed up the slow pace of progress, and that technical assistance from the World Bank should be requested to help the authorities scrutinize the public enterprise sector, particularly in manufacturing. The authorities hoped to list each individual enterprise under one of three categories: those that were nonviable and should be phased out gradually; those that might be divested of public ownership control, or alternatively, might be put under joint venture with public and private ownership; and those that appeared viable, and with some reorganization in structure or rehabilitation might be kept in the public sector. The World Bank staff did not have a timetable of that reform process, but had hoped to provide support and technical assistance during the coming fiscal year. The authorities seemed eager to make further progress on that issue, and although such progress had been slow, it was expected to accelerate in the future.

Mr. Finaish said that one had to appreciate that a fundamental shift in policy had taken place in a relatively short period, particularly over the past two years, and that despite quite difficult circumstances, significant structural and financial changes had occurred in Somalia.

Reference had been made to assumptions of the economic program, Mr. Finaish recalled. Of course, assumptions had had to be made on a number of exogenous variables and on the effects and lags of various measures. However, a number of the assumptions for the program--including some critical ones--simply had not materialized. It was always easy to say in retrospect that an assumption had been overly optimistic. However, it was difficult to see how anyone could have predicted the sharp decline in workers' remittances, which had offset

the 50 percent increase in exports. Therefore, the changed circumstances had made it virtually impossible to achieve the program targets in 1985. Of course, in theory one could say that the balance of payments targets could have been achieved if financial policies had been tightened sufficiently to offset the effects of the adverse exogenous developments. However, given the magnitude of fiscal and import compression that would have been necessary, that tightening could not feasibly have been done in such a short period. It was important to recognize that major budgetary changes required time to be agreed upon and implemented, both in developing countries or industrial countries, and that was indeed the situation in Somalia. Given those circumstances, there had been no choice but to extend the arrangement, which was a wise decision because the momentum of the adjustment had been maintained.

Somalia's outlook was difficult for reasons that were well known, Mr. Finaish continued. The authorities would have to do their part to improve the situation, but support was also needed from donors, especially in terms of the timing of disbursements. As a number of speakers had noted, the terms of such support were also important. The authorities were currently discussing with the staff the possibility of a follow up stand-by arrangement as well as additional resources under the structural adjustment facility.

The interest rate had been increased twice recently, but the authorities held the view that interest rate changes had only limited effectiveness in the current circumstances, Mr. Finaish indicated. Moreover, they considered that in Somalia's depressed situation, they needed to encourage agriculture and industry particularly, and therefore they had doubts about how effective the interest rate instrument was in those circumstances.

The authorities were committed to the unification of the exchange rate, Mr. Finaish went on. Moreover, the authorities had done what they were supposed to do under the program. There was no denying that exchange rate measures were useful, but there were other ways of encouraging exports. Critical imports were needed, for example, and increased production was also necessary.

In their telex to the Managing Director, quoted in Supplement 2 to EBS/86/199 (9/16/86), the authorities had stated their intention to set aside the last purchase in the current stand-by arrangement to be used to repay obligations in Somalia's SDR account that would fall due in the future, Mr. Finaish stated. That measure should be taken as an indication of Somalia's eagerness to remain current with the Fund. However, he was concerned that such a procedure might become a standard requirement for Somalia and other member countries. It was not yet part of the general policies of the Fund, and one could debate the usefulness of such a procedure as well as its advantages and disadvantages. Of course, he recognized that Somalia was one of the countries that had found it difficult to meet its obligations to the Fund, but the authorities' acceptance of that new procedure showed that they wanted to

continue their cooperation with the Fund. Finally, he hoped that the discussions scheduled to take place soon on a follow-up program under the structural adjustment facility would be successful.

The Chairman then made the following summing up:

Executive Directors were in broad agreement with the appraisal in the staff report on the the 1986 Article IV consultation with Somalia. Directors recognized the difficult situation being faced by Somalia--and in particular the institutional and administrative bottlenecks confronting the authorities--and urged the authorities to press forward with the adjustment effort. In that context, Directors expressed concern at the increasingly difficult medium-term prospects faced by Somalia. They were of the view that a quickened pace of adjustment was needed in order to attain a sustainable medium-term balance of payments position. Directors were pleased to note that improved weather conditions and producer incentives had led to a 10 percent increase in real GDP in 1985, and that a further 5 percent increase had been forecast for 1986. However, they acknowledged that even under the best conditions, Somalia would require continued donor support of a highly concessional nature and debt relief for a number of years to come.

Some Directors observed that the coordination between the Somali authorities and the principal donors should be improved to permit a steady flow and timely disbursement of the agreed resources. Concern was also expressed that some of Somalia's difficulties had arisen because policies under the stand-by arrangement--particularly vis-à-vis the external sector and the budget--had not been implemented fully. Some Directors commented that financial policies had tended to be more expansionary in 1985 and in the early part of 1986 than planned, but they commended the authorities on the recently implemented expenditure adjustment that had brought the overall budgetary deficit in 1986 to the level included in the present stand-by arrangement, and on the efforts to expand government revenues for 1986. In that regard, they encouraged the authorities to target a smaller overall budgetary deficit in 1987.

Directors indicated that the authorities should move ahead with tax reform, including a restructuring of import duties and a broadening of the tax base, and that they should press ahead with civil service reform. Directors welcomed the authorities' commitment to unify the foreign exchange market before the end of 1986 and urged them to let market forces determine the adjustment of the official rate so that the target date for the unification

would be met. They commended the authorities for the the successful introduction of the foreign exchange auction system and the maintenance of a liberalized trade system, despite the continued difficulties in the external sector.

Directors viewed the recent improvement in the operations of the commercial bank as an important step toward better financial control. It was noted that the recent adjustment of interest rates was in the right direction but that additional action might be necessary if inflation continued at a high level.

Directors emphasized the need to move forward more forcefully with structural reform. They recommended in particular that the authorities rehabilitate the public sector enterprises with the assistance of the World Bank, improve the provision of financial services by premitting other commercial banks to operate in Somalia, encourage the private sector through improved pricing and taxation policies, and strengthen and diversify Somalia's export potential.

Directors generally expressed serious concern at the continued existence of payment arrears and the authorities' inability to meet the target established for their reduction in 1986. They encouraged the authorities to make additional efforts to eliminate such arrears. In that regard, Directors warmly welcomed the recent elimination of overdue financial obligations to the Fund and urged the authorities to tighten policies and procedures so as to prevent the recurrence of overdue obligations.

It is expected that the next Article IV consultation with Somalia 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 relating to Somalia's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1986 Article XIV consultation with Somalia, in the light of the 1986 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Somalia maintains a restriction on the making of payments and transfers for current international transactions as evidenced by the accumulation of some commercial arrears, and multiple currency practices, subject to Fund approval under Article VIII, Sections 2(a) and 3, as described in SM/86/234. The Fund notes the intention of the Government of Somalia to eliminate the multiple currency practices, which were approved through December 31, 1986 (Executive Board Decision No. 8282-(86/81), adopted May 12, 1986), in the

context of the adjustment program described in EBS/86/93. The Fund grants approval of the restriction evidenced by the accumulation of commercial arrears through December 31, 1987 or the next Article IV consultation with Somalia, whichever is earlier.

Decision No. 8408-(86/161), adopted
September 22, 1986

Stand-By Arrangement - Review and Waiver of Performance Criterion

1. The Government of Somalia has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Somalia (EBS/85/1, 1/2/85) as amended, and paragraph 35 of the letter attached thereto as modified by paragraph 20 of the letter dated April 22, 1986, from the Minister of Finance and the Governor of the Central Bank of Somalia, concerning deviations in the observance of the performance criteria under paragraph 4 of the stand-by arrangement, and in order (a) to review progress made by Somalia in realizing the objectives of its program, (b) to reach understandings on the balance of payments gap and exchange rate, budgetary, and petroleum-pricing policies that the authorities will pursue during the period through September 30, 1986, and (c) to establish suitable performance criteria for the rest of the program.

2. The letter dated September 16, 1986 from the Minister of Finance and the Governor of the Central Bank of Somalia setting forth policies and measures that the authorities will pursue, shall be annexed to the stand-by arrangement for Somalia, and the letters of November 8, 1984 and April 22, 1986 shall be read as modified and supplemented by the letter dated September 16, 1986.

3. Somalia will not make purchases under the stand-by arrangement that will increase the Fund's holdings of Somalia'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, during any period in which the data at the end of the preceding period indicate that:

- (a) the limit on total domestic credit of the banking system described in paragraph 10 of the letter of September 16, 1986, or
- (b) the limit on net credit from the banking system to the Government described in paragraph 10 of the letter of September 16, 1986,

is not observed.

4. The Fund decides, pursuant to paragraph 4 of the stand-by arrangement, that the review contemplated in paragraph 35 of the letter of November 8, 1984, as modified by paragraph 20 of the letter of April 22, 1986, is completed and that no additional understandings are necessary; and that notwithstanding the nonobservance of the performance criteria on net credit to the Government for April 30, 1986, Somalia may proceed to make purchases under the stand-by arrangement.

Decision No. 8409-(86/161), adopted
September 22, 1986

2. MAURITANIA - 1986 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT -
REVIEW AND WAIVER OF PERFORMANCE CRITERIA; AND STRUCTURAL ADJUSTMENT
ARRANGEMENT

The Executive Directors considered the staff report for the 1986 Article IV consultation with Mauritania, the first review under the 12-month stand-by arrangement for Mauritania approved on April 21, 1986, and a request for a waiver of performance criteria, together with a request by Mauritania for a structural adjustment arrangement (EBS/86/192, 8/19/86; Cor. 1, 9/18/86; and Sup. 1, 9/19/86). They also had before them a report on recent economic developments in Mauritania (SM/86/232, 9/9/86).

The Chairman made the following statement:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their September 4, 1986 discussion in Committee of the Whole of a paper entitled "Mauritania - Policy Framework Paper, 1986-1989"

The Executive Directors of the Bank and IDA discussed, in a Committee of the Whole, the paper entitled "Mauritania - Policy Framework Paper, 1986-89."

The deep-seated problems of Mauritania were recognized, as well as its poor resource endowment.

The medium-term framework was commended, although it was thought to be very ambitious. It was noted that while Mauritania's growth potential was limited, this potential would be enhanced by the medium-term program of the Government.

The importance of timely and effective implementation was stressed. The weakness of the administrative mechanism was noted, in connection with the tax system as well as the reform of the

financial sector. The importance of continued and more effective technical assistance was emphasized to help improve the efficiency of the public administration.

Several speakers noted the importance of greater reliance on private investments, and that for this purpose the incentive framework proposed by the Government would need to be sustained.

Several speakers questioned the size of the financing gap. Concern was expressed both on the adequacy of the financing to assure maximum feasible growth and on whether the projected financing could be mobilized. Staff noted that strong donor support would be necessary even to achieve the projected disbursements and debt rescheduling. The projected financing was thought to be the maximum likely to be available, particularly in view of donor reactions in recent discussions.

The staff representative from the African Department said that the staff had been informed on September 21, 1986 that the authorities had taken measures to transfer to the budget an advance on the profits of the petroleum company, as indicated in EBS/86/192, Sup. 1 (9/19/86). The first transfer of UM 100 million had already been effected. On September 19, 1986--before any transfer had been effected--the level of credit to the Government had been reduced to the end-September 1986 ceiling under the program. With the initial transfer of UM 100 million, the net credit to the Government had been brought significantly below the ceiling level.

Mr. Mawakani made the following statement:

The multifaceted efforts initiated by the authorities of Mauritania and aimed at reducing the imbalances in the economy are being continued with added resolve. Indeed, all the policy measures programmed under the 1985 stand-by arrangement have been implemented. Likewise, those slated for implementation in 1986 are being pursued on schedule. The combination of these actions and the advent of favorable factors such as better weather conditions and lower oil prices have led to a revival of economic activity and a reduction of fiscal and external imbalances. Production incentives have been greatly enhanced and the basis for a more sustained growth in the medium term is being strengthened. It is in support of these efforts that the authorities are requesting the joint assistance of the Bank and Fund in the form of a three-year arrangement under the structural adjustment facility.

In the production sector, there are indications that the resumption of growth in 1985 is holding ground this year. Indeed, subsequent to an uneven performance over the past few years, the rate of expansion of total output is projected to exceed 5 percent in 1986, up 2 percentage points from the 1985 level. It is

forecast to remain sustained in the medium term, reflecting to a large extent the favorable effects of the expansion of livestock and cereal output on trade. Equally important toward achieving the growth objectives are several structural policy measures. These measures, which are detailed in the staff reports, are aimed at ameliorating the resource allocation in the economy and strengthening the conditions for a broad-based and sustained economic growth. I wish only to stress the wide-ranging nature of these measures. In the area of prices, not only has the ouguiya been depreciated in favor of domestically produced goods, but the producer prices of many agricultural commodities have been increased in order to stimulate production. The list of goods submitted earlier to price control has also been drastically shortened. Furthermore, the pricing and marketing arrangements for several commodities are being reviewed. The role of the private sector in the marketing and pricing of agricultural products is also being enlarged. In this connection, consideration is being given to allowing the private sector to undertake activities related to the distribution of fertilizer and the processing of rice. The free food program is being scaled down in favor of a more expanded "Food-for-Work Program." Investment selection is being based much more on economic considerations, and project implementation is being strengthened. The fisheries sector is also the object of considerable attention, with emphasis being placed on expanding the involvement of Mauritanian nationals and enhancing the partnership arrangements between the Government and foreign interests. To underscore the increasing importance of the contribution of this sector to the economy, the Government intends to submit early next year an action program to a Sectoral Donors' Group Conference, following the completion of the comprehensive study in progress on ways to better integrate fishing activities into the economy.

In the fiscal sector, the overall deficit has decreased significantly in 1985, owing to the Government's efforts to restrain expenditure growth and to expand revenue. The interplay of the effects of the depreciation of the ouguiya, the recovery of the fishing and iron exports and discretionary tax changes has contributed to the growth of tax revenue. Current expenditure has also been contained through the freeze of important categories of outlays, notably subsidies and transfers. Capital expenditure was reduced as part of an overall consolidation of development efforts. The fiscal adjustment is programmed to continue in 1986 and beyond, with the overall deficit forecast to decrease sharply again this year and more gradually thereafter. To this end, new revenue measures were enacted this year, including higher rates on certain income categories and on petroleum products. Some tax exemptions were also reduced and several others are under review. Ways are being considered to broaden the tax base of the fishing and mining activities. The tax registry is also being reorganized in order to

allow for a more efficient use of the information therein. On the expenditure side, the authorities restrained the increase in the wage bill by allowing only minimal recruitment in a few administrative departments.

On a year-on-year basis, overall monetary expansion has been generally restrained in Mauritania during the past few years and is projected to remain so in the medium term. This moderation is consistent with the more cautious course of fiscal policy being followed by the authorities. In order to enhance the contribution of the banking system to the growth of economic activity, the Mauritanian authorities have initiated several actions involving a fundamental reorientation of policies. By way of illustration, not only is the list of borrowers in arrears being made public but they are being barred from using banking services and bidding for government contracts. The supervisory authority of the Central Bank on the operations of the deposit money banks is being strengthened, particularly by the prevention of banks that fail to provide timely financial information to the Central Bank from having access to its rediscount window. The opening of the capital base of the deposit money banks to foreign and local partners is being considered. Thanks to these and other measures, financial discipline and confidence in the banking system and in the economy as a whole are being reinforced.

Significant progress has also been achieved in reducing the external imbalances. The external current account deficit, including grants, which exceeded more than 20 percent of GDP in 1984, has been more than halved in 1985 and is programmed to decrease further in 1986 and in the medium term. The improvement noted in 1985 was essentially attributable to a rise in export earnings from fish (price and volume effects) and to a lesser extent from iron exports (price effect). Nonfactor income also rose substantially in 1985, owing to higher royalties from fishing activities. Despite the decrease in net capital inflows, the overall balance of payments deficit decreased considerably in 1985. The depreciation of the ouguiya in 1985, together with the implementation of a flexible exchange rate policy, has contributed to achieving this result. For 1986, export earnings are projected to remain practically stagnant, as the favorable effects on receipts arising from higher volume and price of fish and increased sale of iron ore to be marketed are virtually annihilated by the impact of the depreciation of the U.S. dollar. However, because of the projected fall in imports attributable to lower petroleum and food import bills as well as considerably smaller outflows of payments for goods and nonfactor services, the external current account deficit is to decrease further. Indications are that this improvement might exert only a limited influence on the overall balance of payments position because of the effects of a near doubling of amortization payments in 1986. The authorities are aware of these prospects and are hopeful that the measures taken to stimulate production

and exports together with the continued display of discipline in managing aggregate demand, will contribute over time to a reallocation of resources in favor of production activities in general and export-oriented ones in particular, thus leading to an improved performance of the external sector.

To conclude, over the past several years, the authorities have demonstrated their determination not only to redress the financial imbalances that their economy has been experiencing but also to take strong actions toward removing the more deep-seated obstacles to a broad-based growth and development of the economy. Particularly noteworthy are the redirection of policies away from regulation and the increasing incentives and participation of the private sector in economic activity. This reorientation of policies is being reinforced and confidence in the economic prospects of the country is being strengthened. It is the hope of my authorities that the international financial community, as well as bilateral aid donors, will continue to provide them with the requisite financial and technical assistance in order to bring to satisfactory fruition their unrelenting efforts to develop their country.

Mr. Rousset made the following statement:

The Mauritanian authorities are closely pursuing the adjustment process, and all the measures envisaged for the first half of 1986 have been implemented. The authorities' efforts are paying off and considerable progress has been made toward achieving in 1986 the objective of GDP growth of 5 percent, a reduction of the current account deficit to 7.7 percent of GDP, and a reduction of the consolidated government deficit to 1 percent of GDP. Against this background and considering the staff explanations about the overshooting on the performance criteria on net domestic credit, I have no difficulty in supporting the decision relative to the completion of the Article IV consultation.

With respect to the program under the structural adjustment facility, I fully agree with its global objective of achieving an annual rate of growth of GDP of 4 percent a year, while reducing the rate of inflation to 5 percent with the aim of attaining equilibrium in the current account by 1989. Since this program supported by the stand-by arrangement has already focused strongly on structural policies designed to increase production and productivity over the medium term, it is not surprising that the objectives and policies of the stand-by arrangement and those under the structural adjustment facility look very much alike. Because the growth of GDP will stem mainly from the development of agriculture, better integration of the fishery activities, and promotion of light industry, the improvement of the economic framework will be essential.

In addition to the continuation of tight fiscal policies, provision has been made for a number of actions, among which the rehabilitation of the public enterprises and the banking system is of particular importance. I encourage the authorities to continue the rehabilitation of the public enterprise sector, and more specifically, of the electricity and water company. The reduction of the cost of energy is indeed essential to the development of industrial or small-scale enterprises and in particular of the activities that would facilitate a better local integration of fishery activities. This same comment can be applied to the banking system, where beyond the actions already taken to accelerate the collection of nonperforming loans and to tighten the supervision of commercial banks, a comprehensive restructuring must be envisaged. In spite of the social cost that will inevitably be involved in this reform, I strongly encourage the authorities to undertake it, along the lines of the staff report.

I agree that there is a need to increase the contribution of the fishing sector to the economy and I look forward to the presentation of the conclusions of the study presently under way.

I was impressed by the number of measures included in the three-year program under the structural adjustment facility. Moreover, I have noted that many of the complex and far-reaching actions were to be implemented in 1986 or early 1987. I wonder whether this timetable is not somewhat overambitious, and if the Mauritanian Administration is in a position to meet such a timetable, given its institutional weakness. Therefore, I would like to point out that while the authorities should make their best efforts to stick to this program, the donors should at the same time remain flexible if some delays occur in the implementation of such an ambitious set of actions. In conclusion, I support the request for an arrangement under the structural adjustment facility.

Mr. Suraisry made the following statement:

It is refreshing to see that political determination and technical and financial support from donors, the Fund, and the World Bank have helped reverse the deterioration in Mauritania's economy. The turnaround has been remarkable, and in many respects has exceeded expectations. The authorities have demonstrated their commitment to restructuring their economy and improving their productive base by embarking on a comprehensive recovery program. I commend them for the decisive fashion with which they have tackled their economic problems and the political courage that they have shown in implementing the needed policies.

The scope and breadth of the policy measures implemented over the past two years are impressive. They have included price liberalization, exchange rate flexibility, a rehabilitation of the banking system and the public enterprises, and cautious fiscal and monetary policies. The policies have resulted in substantial progress in the past two years to reduce internal and external imbalances. For example, in 1985, the domestic savings ratio improved sharply from a negative 1.9 percent to 9 percent of GDP, the overall government deficit was cut in half to 4.9 percent of GDP, and the external current account deficit was reduced by more than one half, to 10.6 percent of GDP. In addition, during the course of 1985, the authorities eliminated all external arrears. What is remarkable is that the tightening of the financial policies and the improvement of the balance of payments were not achieved at the expense of growth. On the contrary, economic growth reached 3.1 percent, compared with a decline of 0.5 percent a year earlier. Furthermore, developments in the first half of 1986 are very encouraging, with economic growth expected to accelerate to a robust 5.2 percent in 1986, despite the continued restraint in financial policies.

As shown in the staff's medium-term outlook, however, the economic prospects for Mauritania remain difficult, and its overall balance of payments position, fragile. This underscores the need for sustaining the present adjustment efforts so as to consolidate the gains achieved thus far, reduce the vulnerability of domestic economic developments to external factors, and solidify the basis for future growth. In this context, the macroeconomic objectives set by the authorities for the period 1986-89, which form the basis for a loan request under the structural adjustment facility, are appropriate and deserve Fund support. Particularly heartening is the aim of an annual rate of growth of real GDP of about 4 percent, a target that seems feasible in the light of the growth performance in the past two years. Furthermore, the objective of achieving a current account equilibrium in 1989 clearly demonstrates the commitment of the authorities to increase reliance on their domestic savings for financing their investment needs. The savings ratio is expected to increase to 18 percent in 1989, and will cover some 60 percent of investment expenditures. This balance of payments target will also help contain the growth of the country's external debt and will result in a gradual decline in the debt service ratio.

The aims of achieving fiscal balance by 1988, and of generating a surplus by 1989, are commendable and appear consistent with the authorities' objective of releasing more resources to the private sector. While some room remains for broadening the tax base, the scope for increasing tax revenue appears limited. Tax revenues already absorb approximately one quarter of GDP, and hence any further significant increase may adversely affect incentives in the private sector. Continued emphasis will, therefore, have to be placed on a reduction of current expenditure, a reorientation of

public investment, and an improvement in the performance of the public sector enterprises. With the help of the World Bank, the authorities have made considerable progress in rehabilitating public sector enterprises and improving their financial performance.

In the monetary area, I commend the authorities for the measures taken to rehabilitate the banking system, the functioning of which has been hampered by a number of factors, including inadequate management. As the authorities are well aware, a sound financial system is essential for the support of their efforts aimed at enhancing the role of the private sector and stimulating economic growth. The authorities were unable to meet the end-June performance criteria for total credit and net credit to the Government. However, I am satisfied that the steps taken by the authorities will be sufficient to bring net credit to the Government below the ceiling for end-September. Indeed, the information provided by the staff this morning confirms the authorities' determination to keep the program on track. I therefore support the authorities' request for the waiver.

The involvement of the World Bank has been instrumental in the restructuring of the Mauritanian economy and has helped the success of Fund programs. Therefore, I hope that the authorities will soon gain access to the World Bank Structural Adjustment Credit so as to widen the scope of the supply side policies, and sustain the momentum for growth. The policy measures envisaged by the authorities are comprehensive and impressive. Furthermore, the firm commitment demonstrated by the authorities to carry out and broaden their efforts of economic restructuring are commendable and worthy of the Fund's support. In conclusion, I support the proposed decisions.

Mr. Qureshi made the following statement:

It is encouraging to note that the comprehensive medium-term adjustment effort initiated by the Mauritanian authorities in early 1985 has proceeded generally on course, and that notable progress is being made toward meeting its growth and stabilization objectives. As part of this effort, an adjustment program for 1985, supported by a stand-by arrangement, was successfully implemented. The implementation of the adjustment program for 1986, which is also supported by a stand-by arrangement, is for the most part on track. The financial program for the remaining period of the current arrangement appears broadly appropriate.

The authorities' adjustment strategy correctly recognizes that the nature of Mauritania's economic and financial problems requires a broad range of policies. These comprise a set of tighter monetary and fiscal policies and a variety of adjustments of a structural nature. These adjustment policies have already

helped to reduce significantly the fiscal and external current account deficits from the pre-1985 levels and, coupled with more favorable weather conditions, are contributing to a recovery of output growth. The firm pursuit of adjustment policies along a broad front will, of course, need to be carried well into the medium term in order to lay a durable foundation for sustained growth with fiscal and balance of payments viability. The staff's medium-term projections show that while the external financial position will remain under pressure in the next few years and will be marked by financing gaps, the prospect exists that balance of payments viability can be attained by about 1990, with GDP growth being maintained about 4 percent, and the debt and debt service ratios undergoing a gradual decline.

The arrangement under the structural adjustment facility that the authorities have requested should play an important role in helping to realize such a prospect by providing an orderly medium-term framework for the continuation of needed adjustment policies. Policies under this arrangement should focus in particular on improving resource allocation and enhancing and diversifying Mauritania's productive capacity, thereby strengthening the supply response of the economy. The proposed first annual program of the arrangement under the structural adjustment facility constitutes a useful move toward strengthening policies aimed at supply promotion, a move that subsequent annual programs should build upon.

In view of the staff's explanation that the excess credit growth at end-June 1986 had been mainly on account of higher than programmed debt service payments by the Government, and that the end-September credit ceilings are likely to be observed, we can support the requested waiver. It is striking, however, that such a large amount of government debt service payments could not have been foreseen at the time of the finalization of the program in the early months of this year, even though most of these excess payments reportedly took place around that time. A procedural question on which some staff clarification would be helpful is why a waiver is being requested only for the nonobservance of the end-June credit ceilings and not for the nonobservance of the end-April credit ceilings.

A particularly notable feature of the staff's medium-term projections is a large increase in the domestic savings rate. While domestic savings over the past several years have on average been negative, they are projected not only to turn positive but also to average over 15 percent of GDP during 1986-89, rising to 18 percent in 1989. This is a major assumption underlying the projected substantial decline in the external resource gap. One wonders whether the projected increase in the domestic savings rate may not be on the optimistic side, and whether the staff has

attempted to assess the attainability of the projected aggregate domestic savings rate by analyzing prospective trends in the components of aggregate domestic savings, namely, public and private savings.

Gross fixed investment is targeted to average about 21-22 percent of GDP during 1986-89, compared with the average rate of about 34 percent in 1981-84. The staff notes that although the investment rate is thus going to be much lower, improvement in the productivity of investment--or a fall in the incremental capital output ratio--will make it possible to realize higher GDP growth rates with less investment. Thus, the average GDP growth rate during 1986-89 is projected between 4 and 5 percent, compared with less than 2 percent during 1981-84, when the investment rate was much higher. Of course, any increase in the productivity of investment is welcome, as it is one of the main objectives of supply-oriented adjustment policies. Nevertheless, the staff, in making such intertemporal comparisons of the productivity of investment or of the incremental capital output ratio, should take careful account of investment and production lags so as not to underestimate the medium-term investment requirements. For instance, it is possible that a significant part of the higher GDP growth rates now being projected for the next few years is attributable to the coming on stream of investments made in the earlier period of higher overall investment rates. By the same token, the projected slowdown in GDP growth rates after 1989 to about 3 percent or less could result in part from the reduction in investment rates during the period 1986-89.

It is indicated that the projected financing gaps will be filled in part by disbursements from a structural adjustment loan from the World Bank. It would be helpful to know what stage of preparation the loan is currently in and how the amounts being considered for the loan compare with the projected financing gaps. In conclusion, we support the proposed decisions.

Mr. Grosche observed that the overall economic situation of Mauritania had improved markedly in 1985. The authorities were to be commended for the generally timely and appropriate implementation of the stabilization measures agreed under the Fund-supported adjustment program. He welcomed the authorities' emphasis on strengthening market mechanisms, particularly through increasing the role of the private sector in the economy and enhancing the incentives for production in the agricultural and export sectors. Internal and external imbalances had been reduced, while economic growth had increased. Those improvements were remarkable, the more so as they had been achieved against the background of deep-seated structural problems and difficult climatic conditions. He was also heartened to note that further substantial progress was expected in 1986.

The authorities' performance with regard to meeting the program targets had been generally good, and although some deviations had occurred, it appeared that the deviations were temporary and that the program would remain on track, Mr. Grosche continued. That held particularly true for the end-April and end-June deviations from the performance criteria for net credit to Government and total credit. It seemed that since July 1986, developments had been back on track, and he was pleased to hear from the staff that the performance criteria for end-September were expected to be met by a comfortable margin.

He could support the request for an arrangement under the structural adjustment facility, Mr. Grosche stated. The structural objectives under that arrangement, which were appropriate, should be conducive to more efficient use of domestic and external resources, and should thus strengthen the basis for improved growth. However, he agreed with the World Bank Directors who had stressed the importance of timely and effective implementation, which was true particularly for the rehabilitation of public sector enterprises and for the reform of the banking sector. In the latter area especially, the scope for action appeared to be large, although he had some doubts whether the envisaged transfer to the Government of the Central Bank participation in commercial banks would indeed bring about a more efficient functioning of the banking sector. Such a measure should be considered only as an intermediate step, until private ownership for those banks could be established. That plan would also be more consistent with the intentions of the authorities to strengthen the role of the private sector.

He particularly welcomed the appropriately restrictive fiscal and monetary policies that would supplement the structural measures under the structural adjustment facility, Mr. Grosche added. Such policies offered good prospects that Mauritania could achieve a sustainable balance of payments position within a reasonable time frame, although the staff's medium-term projections had entailed quite ambitious goals. The staff scenario had been based on relatively favorable assumptions, in particular a return to better weather conditions, as well as a strict continuation of current adjustment policies. Any major unfavorable exogenous development would lead quickly to a difficult situation.

In conclusion, he was pleased by the results of Mauritania's adjustment efforts, Mr. Grosche commented. He fully supported the proposed decisions, including the waiver for the nonobservance of the criteria on credit.

Mr. Foot made the following statement:

The Mauritanian economy has made significant progress over the past year. The adjustment program initiated in early 1985 has brought about a significant reduction in the massive imbalances

facing the economy, and at the same time has put structural policies in place that will allow a substantial improvement in economic performance.

The authorities will clearly need to maintain their progress in the implementation of far-reaching policy reform in a variety of areas. This would appear to be a prerequisite for reversing the dismal economic performance of recent years. That performance was tellingly illustrated by two facts. It was noteworthy that the production of cereals in 1984-85 was substantially below its level of the late 1960s--a result only partly explicable in terms of poor weather conditions. Moreover, GDP rose by only 1 percent a year between 1981 and 1984, despite the considerable resources devoted to investment during that period.

The adjustment program has attempted to reduce the financial imbalances facing the economy while strengthening the supply response. The effects of these policies seem to have been favorable. Growth recovered sharply in 1985 and may do significantly better again in 1986. The external and fiscal positions have also been significantly improved.

Mauritania's performance under the stand-by arrangement continues to be satisfactory, apart from the unforeseen developments on the credit side. The staff has recommended that we should approve waivers for the overshooting of the end-April and end-June credit ceilings. I can go along with this but I have to add that I hope that my authorities will take a similar view when they receive the relevant staff paper. This is the first paper that I have not been able to transmit in any form to my authorities, and at some point, these delays in the receipt of staff papers will become problematic.

I wonder whether the staff thinks that the unforeseen increase in the debt service requirements is likely to continue in the future, or whether this is more a question of catching up past obligations and bringing forward future obligations. In addition, I presume that the compensatory measures taken by the authorities to increase revenue from the petroleum and fish sectors will yield essentially once and for all revenue increases. That seems to be fairly obvious for petroleum, but less obvious for the fish sector.

Mauritania's program under the structural adjustment facility appears to cover all the key policy aspects. Not surprisingly, the authorities' adjustment efforts are so recent that in several areas, the proposed policy reforms are subject to the completion of studies currently being undertaken with the advice of the World Bank. Nonetheless, if successfully implemented, these reforms should potentially lead to a further significant improvement in the

prospects for Mauritania's economy. In general, the comprehensive range of policy reforms included in the program could perhaps be seen as a model for future requests.

In the fiscal area, the authorities recognize the need for a close examination of the effectiveness of the public investment program. Recent years have shown that the large resources devoted to the public investment program have produced only meager results. In addition to reviewing the investment program, the authorities need to maintain tight control over current expenditure. In this regard, the controls on the public sector wage bill included in the program are a welcome step. However, a more far-reaching review of employment levels would also be desirable. I am glad to see therefore that the civil service is to be reorganized and that a review of manpower levels will be conducted. I am also encouraged to see that the program includes a review of the tax system, again in conjunction with the World Bank. This is particularly important in the light of the widespread exemptions on customs duties and excise taxes that currently mark the system.

As for monetary policy, welcome measures have been taken already to strengthen the financial system and to deal with the problem of nonperforming loans. However, as the staff has suggested, the rehabilitation of the banking system will require a sustained effort, including fundamental changes in managerial and control procedures.

The substantial depreciation of the real exchange rate already in place should help to strengthen significantly the external position. However, there appear to be no quantitative guidelines for the exchange rate in either the stand-by arrangement or the arrangement under the structural adjustment facility. Perhaps the staff would comment on this.

In conclusion, the authorities are to be commended for the efforts they have made to implement a far-reaching adjustment program. They also deserve recognition for their efforts in maintaining good relations with the Fund over the difficult years in the recent past. If fully implemented, the adjustment program will go a long way toward providing the basis for the strong, durable growth that is urgently needed in Mauritania, and I can therefore support the proposed decisions.

Mr. Di Mauro made the following statement:

Recent positive developments in the economic situation of Mauritania seem to demonstrate that the country is on the right track of adjustment. The fiscal deficit, excluding grants, was reduced from the level of 24.5 percent of GDP in 1984 to a projected 10.8 percent in 1986, while the current account deficit declined

from 22.4 percent of GDP in 1984 to a projected 7.7 percent by 1986. Moreover, the authorities' continued concentration on supply-side measures, supported by Fund and World Bank assistance, seems to ensure a gradual rationalization of investment programs and some increase in profitability. However, the economy is still dependent upon foreign assistance and financing, and only a continuous effort to correct the deep-rooted causes of backwardness will be able to bring it to a sustainable, coherent path of growth.

The package of policies, presented today is perfectly consistent with the latter philosophy and is an appropriate follow-up of various far-reaching measures that have already been adopted, both for short- and medium-term adjustment; it certainly deserves our approval. Therefore, we have no difficulties in supporting the proposed decisions.

With respect to pricing policies, we must say that, as was the case with The Gambia, we are concerned about the appropriate role of government agencies that support the prices of certain domestically produced commodities and about the cost and benefit that such support can have for the economy of the country.

A review of the producer prices of rice prevailing between 1980 and 1986 (Table 6, SM/86/232, 9/9/86) shows that the policy followed by the authorities was clearly directed to guarantee a sufficient production incentive for the domestic agricultural sector by sheltering it from the sudden fluctuations in world prices. Although we can agree in principle with the main aims of these policies, we do question their sustainability and appropriateness.

Between 1980 and 1986, the difference between the consumer and the producer prices for rice--namely, the margin that should cover the operating expenses of the state-controlled agency--varied continuously. For example, the consumer price was equal to UM 2 per kilogram in 1982/83 and to UM 12 per kilogram in 1984/85, while the respective producer prices were equal to UM 12.5 per kilogram and UM 14 per kilogram, implying that in certain periods, the state-controlled agency had incurred losses. In that respect, we would like to know what influence the operations of this controlled agency have on the public sector budget, and what the consequences would be if Mauritania dismantled this system. Moreover, we would like to understand which criteria have been used to establish through time the two series of prices. In addition, given the leading role of Senegal in the price-making process for various products handled in the region, we wonder whether a thorough analysis by the staff on this subject should not be in order.

Table 6 of SM/86/232 (9/9/86) shows that the producer price of rice established for 1985/86 in Mauritania, along the lines of the Senegalese prices, is higher than the world price. Just as the price-making role of Senegal has affected the prices of groundnuts in The Gambia, Senegal's regional price-making role could have negative consequences for Mauritania. Apparently Senegal can compensate for the losses incurred in the support of certain products--for instance, groundnuts--products. However, single-product economies suffer badly because of these production support policies.

We are convinced that the role of the Fund in guaranteeing fairer rules of the game between members should be enhanced, and we wonder whether the staff can offer some views on the steps already taken or to be taken on this pricing issue.

With respect to fiscal policy, the authorities are making commendable efforts to reduce the budget deficit for the purpose of increasing the savings ratio. Among the measures proposed to reach this objective, we particularly welcome the indication that on the revenue side, some improvement in tax administration will be effected in due course, while on the expenditure side, an important program of requalification of public investment expenditure is being applied.

We are convinced that the development of a stronger private sector is a matter of priority. While we welcome the projected reduction in public investments, to leave more room for the privately managed ones, we wonder whether the staff could offer more information on the specific means used to enhance the private initiative. Moreover, further information on the functioning of the centralized investment control unit would be appreciated.

With respect to monetary policy, we welcome the projected comprehensive restructuring of the banking system, which follows a long-awaited study on the matter. In this regard, we would like to know about the timing of the projected application of this reform.

Although the financial system of Mauritania is still not very advanced or very responsive, the authorities have nonetheless demonstrated in the past their ability to control monetary aggregates. Therefore, we agree with the staff in considering that the recent slippage in net credit to the Government was due to circumstances beyond the control of the authorities. The measures taken to offset them are reassuring, and we can support the request of the waiver.

Ms. Bush made the following statement:

We welcome the broad-based approach of the program under the structural adjustment facility, and we support the goals, policy directions, and objectives laid out in the policy framework paper and the first-year program. We also welcome the objectives of the stand-by arrangement. However, we are extremely disappointed that the end-April and end-June performance criteria were missed, especially in the light of the fact that we had approved this program late in April 1986.

In many areas, Mauritania's economic performance under the stand-by arrangement has been broadly on track. Economic growth--at some 5 percent--is higher than expected, due apparently to stronger incentives emerging from adjustments in producer prices and further steps toward price decontrol, and the continuing effects of exchange rate adjustments. In addition, exchange rate policies apparently have contributed to a welcome improvement in the current account, mainly attributable to lower food imports. Moreover, the authorities remain committed to maintaining the competitiveness of their productive sectors through adjustments as needed, which will help them to achieve the rather challenging medium-term goals presented in the medium-term outlook. However, we would urge that in conjunction with the maintenance of their flexible exchange rate policy, the authorities should consider accelerating their reform of the price control system. It appears that only eight domestically produced products are still under price controls; I note that a relevant study will be completed in 1987, but I was left somewhat uncertain as to the follow-on plan for action. Perhaps further information could be provided by staff or Mr. Mawakani with regard to the authorities' plans.

In some respects, fiscal performance remains broadly on track, although the fact that debt servicing payments scheduled to be paid in 1985 were not paid until 1986 has contributed to the breach of the credit ceilings. With the recent implementation of additional measures, the increases in revenue will more than compensate for the higher expenditures, and the overall fiscal surplus is now projected to be higher than projections in the original program. In some areas significant steps are being taken: priorities are being assigned in the investment budget, a civil service reform is being initiated, stronger controls on expenditures are being put into place, and tax reforms aimed at broadening the tax base are also being put into effect. In that regard, I note that the authorities, in conjunction with the staff, are planning a tax reform study, focusing to some extent on improved collections and reduced exemptions. I wonder whether some emphasis is also being placed on the efficiency of the tax system with regard to marginal rates. I would be interested in knowing what the marginal rates are now, and wonder whether there will be any attention given to some reduction of dependence on export taxes, which would be

important for a country such as Mauritania, which is trying to diversify and increase its exports. In addition, we support the initiation of the civil service reorganization being undertaken with World Bank assistance, and we believe that Mauritania's human resource development, focused on education and training, is important to the economic development of the country.

With regard to the performance criteria under the stand-by arrangement, we were disappointed that steps aimed at bringing the Government's use of credit back under the June ceiling were delayed, leading to a breach of performance criteria at end-June 1986. As I understand it, the performance criteria were missed both in April and in June under a program that had been approved only in April 1986. Initially a question had been raised in our minds as to whether, because these ceilings had been missed and because of questions that had existed about the September targets, perhaps some rephrasing of purchases might not have been in order. However, we are now more confident, based on the strong statements that have been made this morning about the September performance criteria as well as the strong fiscal performance this year, and thus we are willing to go along with the staff's suggestion.

One area of good progress is structural adjustment. We found the timetable for policy implementation extremely helpful. We also welcome the inclusion of policy measures with regard to the benchmarks as well as the quantitative enumeration of benchmarks. We view the emphasis on agricultural and fisheries development as generally appropriate, and welcome in particular the privatization of some of the mills in the rice sector. We understand that additional reforms in the agricultural sector, with a strong emphasis on private sector development, are being formulated with the assistance of the World Bank. We of course support all these efforts.

We are pleased to note that the authorities with the World Bank's help have begun to rehabilitate some specific public enterprises, such as the water and electricity company and the petroleum distribution company. The Government is committed to privatizing nonstrategic enterprises, and we would appreciate any details of the authorities' intentions in this area in addition to the livestock company that had been mentioned. Related to this is the rationalized approach to the public sector investment program, now being supported by a higher proportion of external grants than expected. Efforts to promote more private investment are also welcome, including in particular, steps toward general price decontrol and eased administrative requirements.

As other Directors have mentioned, the banking sector appears to be accorded an appropriately high priority. Reforms have begun and will continue under the program under the structural adjustment facility. The authorities are taking steps where needed to provide

some support, but importantly, bank-by-bank improvements in managerial capability and control procedures are being put in place. The Government is also planning to bring in foreign equity participation and reduce its own equity participation in the banks, which could also help improve performance if access to government support is made less automatic. Furthermore, the efforts to strengthen the banking sector through appropriate interest and exchange rates could provide a boost to private savings, including workers' remittances.

As the staff mentioned trade and exchange reforms only briefly, we would appreciate any additional details that could be provided. A study of the system apparently will be completed in 1987, but we were unclear about the actual implementation or timing for implementation of measures that might come out of that study. This could be important, since we are looking at a three-year framework.

The combination of these measures, with continued consistent implementation, could lead to a rapid improvement in the current account and overall payments positions and a diminution of the financing gaps in the medium term. This adjustment would also bring a necessary reduction in the external debt burden--over 200 percent of GDP--and in the debt service ratio--currently over 40 percent. In that regard, we view financing such as that under the structural adjustment facility as much better suited to a country like Mauritania, in which the debt service burden is so high. It might have been helpful if the policy framework paper had included a tabular presentation of the financing needs over the three-year program. Such a table helps to focus the attention of the donors on the actual financing needs. We note that there is considerable detail in EBS/86/192 (8/19/86) with regard to the reforms under way in the banking sector. However, in several instances mention is made of improving incentives, but there are few specifics on how those incentives would actually be improved; more specificity on such issues in a framework paper would be welcomed. It is important to include such specifics, given that some framework papers might stand on their own without being accompanied by other papers or even necessarily by a program.

With these comments in mind, we can support this request for the first annual program under the structural adjustment facility as well as the decision on the review under the stand-by arrangement.

Mr. de la Herrán made the following statement:

We had a discussion on Mauritania in April 1986 at the time of the approval of the present stand-by arrangement. I would like to take advantage of today's discussion to reiterate our satisfaction

with the good performance of the Mauritanian economy. Let me say at the outset that we support the proposed decisions, including the waiver requested by the authorities.

Progress in 1985 was greater than expected. The main economic indicators for the fiscal deficit, economic growth, and balance of payments situation indicate substantial improvement. The first part of 1986--excluding the slippages within the credit policy-- has also registered good results, reflecting a consolidation of the trends that began more than a year ago. Economic growth figures illustrate this improved situation: from a negative growth of 0.5 percent in 1984, the country achieved 3.1 percent growth of real GDP in 1985, and 5.2 percent is expected for 1986.

Despite these steps forward, the main problems of Mauritania's economy will still need a strong dose of attention and in-depth changes. The roots of the major imbalances are primarily of a structural nature. In this regard, we are particularly pleased with the manner in which the Fund, in close collaboration with the World Bank, has focused on the relations with Mauritania. It is crucial to enhance the medium-term aspects and to concentrate efforts and financing in schedules of such medium-term nature. To this end, the combination of a stand-by arrangement and a program under the structural adjustment facility, together with a structural loan from the World Bank, seems to be the correct answer to the present needs.

The main weakness of the fiscal sector seems to be affecting the revenue side. Developments in 1985 and early 1986 have been satisfactory on an overall basis, but the achievements were not reached without revenue shortages, mainly induced by difficulties in the tax collection process and in the administrative organization of the tax system. This recent experience calls for an urgent and thorough tax reform. As stated by the staff, one aspect to which special attention should be devoted is the current, rather distorted system of fiscal exemptions. We are very much in favor of a profound reform in this area, one that would eliminate such exemptions as much as possible, thus endowing the system with greater transparency and enabling the authorities to make more reliable projections on the amount of tax receipts that will be available.

The external sector certainly constitutes the most vulnerable flank of the economy in Mauritania. Despite the recent remarkable progress, the debt situation remains serious and the financing needs will be covered only after further negotiations and rescheduling rounds with creditors. Nevertheless, it is worth mentioning the positive results obtained in 1985 in the trade balance and the much better than originally expected perspectives for the current account in 1986, with a deficit of 7.7 percent of GDP now forecast, compared with that of 9.5 percent initially programmed.

The somewhat alleviated situation provides a certain leeway in the external balance of the economy. This factor permitted the rescheduling agreement reached in Paris in May 1986, together with the expected disbursements obtained from the Fund and the World Bank, to be an adequate financial cushion. However, the real problem is the uncertainty surrounding any projection that could be made, an uncertainty stemming primarily from the natural factors or endowment of Mauritania. This element indeed constrains spectacular resurgences of growth rates and makes the economy extremely vulnerable to factors that are beyond any economic policy control. All in all, the perspectives now are more optimistic than they were a year ago. In addition, it is hoped that the reforms designed for the medium term will provide a wider basis for improvement based upon further developments in the tradable goods sectors.

I would like to ask whether the staff could offer some further comments on the projected decline of 15.2 percent of imports for 1986 and on the price of imported crude oil assumed in the forecast. The medium-term policy framework designed in collaboration with the Fund and the World Bank is most comprehensive, although I share Mr. Rousset's opinion that it might be rather ambitious. It covers a good number of issues, includes an impressive set of targets, and touches upon almost every possible area of the economy. In this regard, it would be helpful to have a more detailed description of specific actions as well as some mention of existing priorities in this field of the reforms.

With respect to the macroeconomic objectives of the three-year program, an annual rate of growth of GDP of 4 percent a year, a decline in the rate of inflation from the current 7 percent to 5 percent by the end of 1988, and the achievement of external current account equilibrium by 1989 seem feasible and in line with the rest of the program, and offer some light on how the several steps will be realized.

The question of financing needs and potential gaps is quite worrisome. The rescheduling terms obtained in the Paris Club have already been generous, and the terms of bilateral agreements still pending and future debt relief will depend primarily on the performance of the economy in the short run, which will determine the room that the authorities have to achieve a viable position and to avoid the buildup of new external arrears. The structural adjustment loan of the World Bank, together with the remaining drawings under the stand-by arrangement and the disbursements under the structural adjustment facility, should provide adequate additional financing to support the projected reforms.

The staff representative from the African Department said that with respect to the excessive growth of credit to the Government in the first months of 1986 and how that was related to higher debt service charges, it had been difficult to identify the appropriate debt service charges when the program was prepared, given the number of uncertainties at the beginning of 1986. For example, the exact amount of the charges connected to the Paris Club reschedulings of previous years had not been known, and there had been uncertainties about other bilateral reschedulings as well. Moreover, some of the uncertainties were attributable to less than optimal management in the Ministry of Finance; certain payment orders had been issued in December 1985 for paying relatively large obligations, but the Treasury had not settled those orders. At the end of 1985, the performance criterion on credit to the Government had been observed, and in fact in November and December 1985, credit to the Government had declined substantially, which had been surprising. Although the authorities had had a margin to make those payments in late 1985, they had not done so. If the payments had not been made during the first months of 1986, Mauritania would have come close to meeting the performance criteria for April 1986. The staff had stressed the importance of rectifying technical problems to eliminate delays and uncertainties. Given the delays in settlement and the rescheduling charges, the debt service was expected to be about UM 700 million more than projected in the program, and that amount would have to be offset by the resources of the petroleum and the fishing sectors.

Whether the additional tax resources from petroleum were once and for all resources, the staff representative continued, could be answered both affirmatively and negatively. To the extent that petroleum prices remained stable, then those resources--which were actually profits resulting from the difference between the decline in the import price and the price of petroleum products--remained broadly stable. Those differences should even accrue in 1987. As for fishing revenues, if the very good fishing season of 1986 was repeated in 1987, and if fishing exports remained stable or in line with the projection, then the higher fishing revenues for the Government should exist in 1987 as well.

A domestic savings ratio increase was projected in the program, the staff representative remarked. A sharp increase had already occurred between 1984 and 1986; the data showed that in 1985 there was a 9 percent savings ratio and in 1986, a 12 percent ratio. Of that 12 percent, 4 percent resulted from the treasury surplus. The mining company profits before amortization were approximately 5 percent of GDP. Amortizations were obviously large, but those were savings in gross terms. The profits of the fishing sector were also large, about 3 percent of GDP. Mauritania had two export sectors that accounted for a large percentage of GDP. The program projections had started with a relatively high base in 1986 of 12 percent, and with some fiscal adjustment, it should be possible to have a domestic savings ratio that exceeded 15 percent toward the end of the period.

Responding to a question on the impact that the decline in the investment ratio might have on GDP, the staff representative recalled that in the past, when the investment ratio had been about 30 percent, a large part had been channeled toward infrastructure--schools, roads, and the like--which had a relatively long rate of return. Those investments, financed with concessional resources, had also led to a debt service, and even interest rates of 2 or 3 percent were relatively burdensome for a country with a large debt. Thus, new investments had to be concentrated in the most productive sectors, and in the rehabilitation of equipment that was already in place; such new investment projects were indeed foreseen for the next two or three years. GDP growth needed to be sustained by sectors such as agriculture and fishing, which did not require enormous investments. Therefore, the staff agreed with the World Bank analysis that a lower investment rate would still be compatible with GDP growth projections of about 4 percent. Of course, there might be some impact on employment because a large investment ratio in the past had probably contributed to employment.

Table 4 in Appendix II to EBS/86/192 (8/19/86) provided data on the potential amounts to be drawn under the World Bank structural adjustment credit in comparison with the financing gap of Mauritania, the staff representative noted. The amount of the structural adjustment credit still had to be finalized, but the World Bank was thinking in terms of \$30-35 million. The financing gap would have to be covered mainly by debt rescheduling and if the debt rescheduling was on terms in 1987 similar to those of 1986, the financing gap would be fully covered. In the staff projections for 1988 and 1989, the financing gap declined and therefore the need for rescheduling would be lower than in 1986. In fact, the staff's projection for the financing gap in 1990 was nearly zero.

The guidelines for the exchange rate stipulated that quarterly adjustment was to be done taking into account the rate of inflation, with the aim of having an additional depreciation in real terms over the period of the program of about 4 percent, the staff representative indicated. The quarterly adjustment had been done on schedule by the Central Bank.

The differential between producer and retail prices had not been stable in the recent past, which had raised the question of what impact that instability might have had on the public agency in charge of agriculture, the staff representative mentioned. There had been some deficits in that agency, but recently the domestic production of rice had been quite low because of the drought, and accordingly, any agency losses on that count had been small. The food stabilization agency received its main financing from the sale of food from donor countries and therefore there had been no impact on the budget. Moreover, the marketing costs for domestic crops that had led to a differential between the producer and retail prices had been covered in part by a donor country. Nevertheless, structural changes were needed in the agricultural sector, and more efforts were needed to contain the cost

of distribution. The World Bank was studying Mauritania's price structure, and assistance was being provided to the food distribution agency to help it cut its costs. A goal for the future was to have costs fully covered so that Mauritania did not have to rely on resources from donor countries.

It was true that in Mauritania the producer price for rice was higher than the international price, the staff representative continued. The price of rice had been increased substantially in recent years because the price prevailing in 1985 had not provided sufficient incentive. With the sharp decline in 1986 in the international price for cereals as well as the exchange rate changes, the producer price now exceeded the international price. While Mauritania's agricultural sector was not so efficient in rice production as was Thailand's, for example, the agricultural sector--with its considerable potential for growth and for employment--should be strengthened, and therefore the high producer price was not unjustified from an economic point of view.

The authorities had already taken a number of steps to bring about the reform of the banking system, the staff representative commented. It was expected that agreement would be reached toward the end of 1986 in the ongoing negotiations with foreign banks to recapitalize the banking system. The World Bank, in its negotiations for a structural adjustment credit to Mauritania, was giving high priority to the banking system reform. In 1987, the authorities planned to finalize a restructuring of numerous operations, to continue with recapitalization, to transfer bad loans to the recovery agency, and to effect changes in accounting. It would probably be early 1988 before the banking reform was fully in place.

In 1985 and early 1986, the authorities had substantially reduced the number of prices under control, so that only eight commodities were still subject to controls, the staff representative remarked. In principle the Government was in favor of and supported relatively faster liberalization and the reduction of the number of commodities for which price controls still existed. The authorities had not been able to take additional decisions in mid-1986 because they had already taken important steps to reduce the list to eight products. However, in the context of an accelerated program of price liberalization in 1987, the staff might be able to negotiate a further reduction in price controls.

Under the current tax system, the marginal rate was relatively high, but it applied to only a few taxpayers, the staff representative explained. Another relatively high tax was currently being paid in the export sector, with an export tax of about 12 percent on fish products. Mauritania depended heavily on that export tax for its revenue, but the World Bank was studying the possibility of shifting from an export tax on sales to a tax on profits. Taxation of the mining sector was also being re-examined.

The privatization of the public enterprises was being realized by the sale of a number of small public companies, as well as by the transfer of public enterprise functions to the private sector, the staff representative went on. For example, the authorities were transferring some of the functions of the public petroleum company to private and international petroleum companies, and they were transferring rice milling and transportation activities to the private sector.

Further incentives for the private sector would include price liberalization, an increase in producer prices, and reforms in the investment code, the staff representative added. Moreover, the World Bank was exploring ways of streamlining the assistance to private enterprise that was being offered by certain public agencies in order to enhance the capability of the small manufacturing sector.

In connection with the authorities' plans to effect trade and exchange reforms, the World Bank was studying the level of protectionism in Mauritania with a view to reduce it and make it more uniform, the staff representative indicated. While the exchange system was relatively flexible, it was centralized in the Central Bank, which had a monopoly on exchange and reserves. In the context of banking reforms, the staff and authorities would be looking in 1987 at the possibility of giving commercial banks a more important role in the provision of foreign exchange. However, some of that decentralization had been hampered in the past because the commercial banks had not been sufficiently reliable and had had difficulties in their current operations.

Table 6 (EBS/86/192, Appendix II, 8/19/86) displayed the staff's external debt projections for Mauritania in the medium term, including disbursements on medium-term loans under existing and new commitments, the staff representative from the African Department pointed out. Although the staff had not given a detailed breakdown of how the financing gap would be covered, the staff's calculations had indicated that the debt relief was more than sufficient to cover the financing gap.

The staff representative from the Exchange and Trade Relations Department explained that the waiver had been requested only for June performance criteria and not for those of April because the standard format of stand-by arrangements was to phase purchases on a cumulative basis. Thus if a member had failed to make a purchase because it had failed to meet one set of performance criteria, it would be able to make that missed purchase, plus the subsequent purchase, when it met the subsequent performance criteria. If the June performance criteria were waived for Mauritania, the authorities could make the purchase linked to the April criteria as well as that linked to the June performance criteria.

Mr. Mawakani made the following statement:

As Executive Directors have noted, the Mauritanian authorities have made significant progress in reforming the economy and reducing the internal and external disequilibria. As I stated earlier, the various measures taken by the authorities over the past few years and the support of institutions such as the Fund have played a role in bringing about these results. Executive Directors have also observed that major imbalances remain in the economy, in particular the narrow production base, the fairly substantial fiscal deficit, and the debt service problem. The authorities are fully aware of these difficulties and remain determined to address them. The medium-term program that they have formulated in the context of the structural adjustment facility constitutes a major step in this direction. The policy changes that they have already introduced and might adopt, together with the support of external sources, will over time strengthen the basis for sustained growth and development in the coming years.

The Chairman then made the following summing up:

Executive Directors generally endorsed the appraisal in the staff report on the 1986 Article IV consultation with Mauritania. Noting the most recent steps taken by the authorities, Directors commended them for the strong adjustment measures implemented since early 1985 under the Fund-supported programs. In particular, they welcomed the decisive supply-side measures, including the significant depreciation of the real effective exchange rate, the increases in the prices of cereals, the price liberalization, the program for public enterprise rehabilitation, and the rationalization of the investment program to support directly productive activities. They also commended the authorities' actions to contain domestic demand through a tightening of budgetary policies and restrictive credit policies. In that context, Directors noted the recent measures to keep the Fund-supported adjustment program on track: an excessive credit expansion in the first half of the year had been corrected since July, and all end-September performance criteria were expected to be met.

Directors welcomed the much improved growth performance in 1985-86, the reduction in the rate of inflation, the reduction in the fiscal and external current account deficits, and the marked rise in gross domestic savings. Directors generally endorsed Mauritania's medium-term macroeconomic objectives set out in the policy framework paper. They observed, however, that despite the recent and prospective improvement in the fiscal and external positions, the imbalances in the economy and the external debt burden remained very large and would require the continuation of firm adjustment policies for a number of years. In those circumstances, Directors stressed the importance of further improving

the domestic savings performance, which was essential for the adjustment effort. To that end, they urged the authorities to continue to pursue vigorously the program for restructuring public enterprises, with the assistance of the World Bank. Directors agreed with the Government's decision to institute a centralized investment budget by 1987 to permit rigorous selection, programming, and monitoring of public investments. They expressed support for the proposed civil service reform and encouraged the authorities to undertake tax reform. Directors stressed that a sound banking and financial system was important for Mauritania's economic development. In that light, Directors endorsed the initiatives already taken by the authorities to rehabilitate the banking system and to restructure the commercial banks.

Directors welcomed the flexible exchange rate being pursued to strengthen exports and import substitution. Directors emphasized the role of pricing policy and the mobilization of private initiative in increasing production in agriculture and in other sectors of the economy. They stressed the importance of the efficient use of foreign assistance to finance productive projects in agriculture, and to strengthen the planning and organizational capability of the state food agency. While welcoming the Government's recent initiative to introduce a structure of energy and electricity prices more consonant with the need of the production sector, some Directors mentioned the need for further progress in the rehabilitation of the water and electricity company.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Mauritania's exchange measures subject to Article VIII, Section 2, and in concluding the 1986 Article XIV consultation with Mauritania, in the light of the 1986 Article IV consultation with Mauritania conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the elimination of exchange restrictions evidenced by the accumulation of external payments arrears.

Decision No. 8410-(86/161), adopted
September 22, 1986

Stand-By Arrangement - Review and Waiver of Performance Criteria

1. Mauritania has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Mauritania (EBS/86/70, Sup. 1, 4/23/86) and paragraph 4 of the letter of the Minister of Economy and Finance and the Governor of the Central Bank of Mauritania dated February 4, 1986, annexed thereto, in order to review policies and establish performance criteria for the second semester of 1986, and to reach understandings subject to which Mauritania may make further purchases under the stand-by arrangement.

2. The letter dated June 26, 1986 from the Secretary of State in charge of the Budget and the Governor of the Central Bank of Mauritania (Appendix I to EBS/86/192) shall be attached to the stand-by arrangement for Mauritania, and the letter dated February 4, 1986 shall be read as supplemented by the letter of June 26, 1986.

3. Mauritania will not make purchases under the arrangement that would increase the Fund's holdings of Mauritania's currency in the credit tranches beyond 25 percent of quota during any period in which the data at the end of the preceding period indicate that the limit on total net domestic credit of the banking system specified in paragraph 7 of the letter of June 26, 1986 has not been observed.

4. In view of the understandings reached with Mauritania in the context of this review, the Fund decides that the review is completed and that, notwithstanding the nonobservance of the performance criteria for end-June 1986 on total domestic credit and net credit to the Government, Mauritania may proceed to make purchases under the arrangement.

Decision No. 8411-(86/161), adopted
September 22, 1986

Structural Adjustment Arrangement

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

2. The Fund approves the arrangements set forth in EBS/86/192.

Decision No. 8413-(86/161), adopted
September 22, 1986

3. EXECUTIVE DIRECTOR

The Chairman made the following statement:

We have all been very shocked and saddened by the most untimely death of Mr. Joyce, former Executive Director from Canada who had left the Executive Board less than a year ago after more than four years of service. He was subsequently appointed by his Government to the prestigious position of Ambassador to the European Communities in Brussels, a post that he occupied at the time of his death.

We all admired and respected Mr. Joyce as an Executive Director. He searched continuously for common ground and the reconciliation of seemingly conflicting positions. His contribution to our work was invaluable. In a way, he was the conscience of the Board. In addition to a fine mind and a very competent approach to our problems, Mr. Joyce also brought exceptional human qualities to his work. He was a generous, compassionate man, and he possessed a very good sense of humor. We will miss him. In the name of us all, I will offer our sincere condolences to Mrs. Joyce.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/160 (9/19/86) and EBM/86/161 (9/22/86).

3. RULES AND REGULATIONS AMENDED SINCE THE 1985 ANNUAL MEETING

The Executive Board approves the letter to the Chairman of the Board of Governors submitting for review by the Governors the texts of amendments to the Rules and Regulations adopted since the 1985 Annual Meeting and the proposed Resolution for the Board of Governors, as set forth in EBD/86/250 (9/17/86).

Adopted September 19, 1986

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/15 and 86/16 are approved. (EBD/86/249, 9/15/86)

Adopted September 19, 1986

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/86/217, Supplement 1 (9/18/86) is approved.

APPROVED: June 5, 1987

LEO VAN HOUTVEN
Secretary

