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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/183

10:00 a.m., November 17, 1986

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

| Executive Directors | Alternate Executive Directors |
|---|---|
| A. Abdallah | E. T. El Kogali |
| | J. A. K. Munthali, Temporary |
| | Song G., Temporary |
| C. H. Dallara | |
| | L. Hubloue, Temporary |
| | J. J. Dreizzen |
| | A. H. Mustafa, Temporary |
| | K. Murakami, Temporary |
| | B. Goos |
| | J. Reddy |
| | J. Hospedales, Temporary |
| | M. Foot |
| | R. Fox, Temporary |
| | I. Puro, Temporary |
| | W. N. Engert, Temporary |
| Mawakani Samba | C. V. Santos |
| | I. Al-Assaf |
| | E. Ayales, Temporary |
| H. Ploix | V. Rousset, Temporary |
| | J. de Beaufort Wijnholds |
| | C.-Y. Lim |
| | O. Kabbaj |
| | A. Vasudevan, Temporary |
| | N. Kyriazidis |

L. Van Houtven, Secretary
A. Akanda, Assistant

*Also Present*

IBRD: F. Agueh, Eastern and Southern Africa Regional Office; L. E. Hinkle, Western Africa Regional Office. African Department: R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director; J. Artus, Buu H., E. A. Calamitsis, J. A. Clement, K. Enders, S. N. Kimaro, M. C. Niebling, S. M. Nsouli, D. Ordoobadi, L. Schmitz, R. T. Stillson, P. C. Ugolini. Asian Department: M. A. Pinho. European Department: J. S. Van't dack. Exchange and Trade Relations Department: S. J. Anjaria, E. Brau, E. O. Kumah. IMF Institute: M. A. R. Andrade, Participant. Legal Department: H. Elizalde. Research Department: A. Mullor-Sebastian. Treasurer's Department: D. V. Pritchett. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, L. P. Ebrill, P. Péterfalvy, I. Sliper. Assistants to Executive Directors: J. R. N. Almeida, G. K. Hodges, A. Iljas, J. M. Jones, K.-H. Kleine, M. Lundsager, T. Morita, J. K. Orleans-Lindsay, V. Rousset, C. A. Salinas, G. Schurr, G. Seyler, S. Simonsen, B. Tamami, E. L. Walker.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Corentino Santos, Alternate Executive Director, to the Board.

2. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director said that he had opened the colloquium on macroeconomic policy management held in Beijing the previous week, which had covered a number of major subjects in the field. Approximately 150 individuals had participated in the colloquium, representing different agencies throughout China, including the planning agency, branches of the central bank, and related financial institutions.

The development of domestic financial markets and China's linkages to the international capital markets were of particular interest in present-day China, the Deputy Managing Director noted. At all the meetings that he had attended, the participants had raised many questions relating to the evolution of the domestic financial system and to the continued growth of China's participation in the international capital markets. In that connection, he had visited Shanghai to observe the operations of the local money market where state financial institutions negotiated transactions in various financial instruments. The expectation was that the money market would grow over time and be complemented by the development of the equity market that had also begun to operate in Shanghai.

All in all, his first visit to China had confirmed what he had read about the dynamism of the economy and the progress being made in various areas, particularly housing construction, the Deputy Managing Director remarked.

3. NIGER - STAND-BY ARRANGEMENT AND STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered a staff paper on Niger's request for a 12-month stand-by arrangement in an amount equivalent to SDR 10.11 million together with a request for a three-year structural adjustment arrangement in an amount equivalent to about SDR 15.8 million (EBS/86/237, 10/24/86).

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 Acting 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 discussion as Committee of the Whole of a paper entitled "Niger - Medium-Term Economic and Financial Policy Framework (1987-1989)," held on October 23, 1986.

The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the paper entitled "Niger - Medium-Term Economic and Financial Policy Framework (1987-1989)."

Directors welcomed the three-year program set out in the policy framework paper. There was general praise for the continued commitment of the Government of Niger to structural adjustment. Positive results had already been achieved in reducing the fiscal and external deficits. Important actions had also been taken to improve the efficiency of public resource management and to restructure the public enterprise sector. Directors noted that many of the details of the medium-term adjustment program had already been discussed by the Board in February 1986, when the Niger Structural Adjustment Loan was approved.

Directors had two specific, related concerns. The first was that, in spite of all the adjustment efforts undertaken by the Government, growth prospects would remain very dim over the medium-term future. After an average rate of economic growth of 2.1 percent in 1987-90, real GDP growth would approach only 3 percent in the early 1990s, still just barely over the rate of population growth. The outlook for uranium exports was very bleak, and the possibilities for alternative export products were very few. A resumption of the export of livestock products had to await a reconstitution of the herds after destocking during the drought of 1983-84, and basic research was still needed to identify new agricultural crops with export potential.

The Directors' second concern related to the size of the available external financial envelope. Many Directors stressed Niger's need for adequate financing for a growth-oriented, productive investment strategy as well as for financial restructuring. According to staff projections, about $50 million per year would be needed in additional concessional funding in order to replace the resources that had previously been provided by debt reschedulings. Continued reschedulings on the same terms and conditions as in the past would not provide adequate support. Reschedulings have been obtained on nonconcessional terms, which are inappropriate for Niger's level of development, and have provided only temporary relief of the debt servicing burden. Replacing the resources that have been provided by these debt reschedulings by additional concessional assistance would imply an increase in the latter of about 25 percent over recent levels. In order to achieve higher investment and growth rates than projected in the medium-term policy framework, as some Directors believed desirable, substantial amounts in addition to the aforementioned $50 million would be required.

The staff reported that the Government was in the process of preparing a detailed financial plan for the adjustment period with UNDP and Bank assistance. This plan would be presented at a planned UNDP Round Table meeting for Niger, which will take place next year. A key objective of this meeting would be to obtain the rest of the financing required for the adjustment period. In the meantime, the Government should gradually move away from debt rescheduling, refrain from borrowing except on very concessionary terms, make sure that all available resources are used efficiently, and urge donors to help with nonproject aid and recurrent cost financing.

Directors encouraged the Nigerien authorities to continue their disciplined economic management and to carry through the necessary adjustments, in spite of the limited growth prospects. Particular emphasis was put on continued parastatal reform and on careful public resource management. The burden of public enterprises on the budget should be reduced, and private initiative and market liberalization should be promoted to the extent feasible. Directors suggested examining the possibilities of reducing still further the number of enterprises to remain in the public sector and encouraged the Government to seize all opportunities for privatization. Staff confirmed that the detailed action programs for public enterprise reform and price liberalization, that had been agreed under the SAL, were all on track.

Similar remarks were made with respect to the improvements needed in the area of public resource management. In view of the relatively low public revenue to GDP ratio in Niger, further efforts were needed to reform the tax system, increase cost recovery, and stimulate domestic resource mobilization. As to public expenditure, efforts should continue to contain the Government wage bill, reduce public subsidies, and make greater allowances for operation and maintenance of existing public assets.

Mr. Mawakani made the following statement:

The staff report presents an up-to-date assessment of economic and financial developments in Niger that were discussed about five months ago when the 1986 Article IV consultation with Niger was concluded and the Executive Board reviewed the present stand-by arrangement, which ends on December 4, 1986.

As the staff rightly points out, since 1983 the authorities have undertaken adjustment measures in the context of a series of stand-by arrangements. The programs were largely aimed at correcting the economy's internal and external financial imbalances that had been caused mainly by the sluggish demand for the principal export, uranium. Significant progress has been made under these adjustment efforts despite a number of adverse factors beyond the control of Niger, particularly the recurrent drought, the worsening terms of trade, and the closing of the border with Nigeria. With renewed vigor and stronger adjustment efforts, the authorities, under the 1985/86 stand-by arrangement, reversed the negative impact of those exogenous factors. The successful outcome of the wide-ranging supply and demand-management measures that were being implemented under the 1985/86 program was nevertheless aided by factors such as better weather conditions, the reopening of the border with Nigeria, lower prices of imported petroleum products as well as the appreciation of the U.S. dollar against the CFA franc. As a result, a significant reduction of the domestic financial imbalances and a considerable improvement in Niger's overall external sector position have been recorded. However, the rate of growth of real GDP is estimated to have shown a slight decline compared with the program target because of insect infestation of agricultural crops and an uneven pattern of rainfall.

Despite the gains that have been made over the past few years, financial imbalances persist. The lingering effects of those imbalances have brought to the fore the economy's major structural weaknesses that have hindered further progress toward the important objective of a sustainable rate of growth in an environment of relative financial stability over the medium and long term. As stated in the letter of intent requesting the stand-by arrangement and arrangements under the structural adjustment facility, as well as in the medium-term economic and financial policy framework paper, the authorities consider it crucial for the attainment of that objective that, given the country's limited resource base, its landlocked position, and its heavy dependence on an agricultural sector that is highly vulnerable to the vagaries of the weather, those structural problems be addressed. The policies to be pursued over the period 1987 to 1989 will essentially follow the main theme of those being under the current stand-by arrangement and the structural adjustment credit from the World Bank.

Over the medium term, the authorities are directing their efforts mainly at expanding the country's productive capacity to ensure that, by the beginning of the next decade, a sustainable increase in per capita income of the people would be recorded. It is also part of their key objective to minimize inflationary pressures and achieve a further reduction in the external current account position. The authorities are aware that the progress made in reducing the financial imbalances should be consolidated so that large imbalances do not recur and jeopardize their medium- and long-term growth objectives. Accordingly, they are undertaking, within a medium-term context, a one-year stabilization program for 1986/87 that aims at reducing the structural impediments to growth and financial stability. The major quantitative objectives are to achieve an increase in real GDP of about 2 percent, a reduction in the inflation rate to 6 percent, a decrease in the external current account deficit to 2 percent of GDP, and a further narrowing of the consolidated budgetary deficit.

The specific economic policies and measures that are being implemented or envisaged under the stabilization program are detailed in the staff report and summarized in Table 5. It only needs to be emphasized that the authorities are committed to the pursuit of policies for improving overall fiscal performance through rationalization of the tax system and implementing expenditure-restraining measures, strengthening the public investment programming process within the three-year rolling investment program that places emphasis on reorienting investment to the productive sectors.

In the industrial sector, an increase in activity is expected in 1987 owing to the domestic trade liberalization policies being followed, as well as the reforms taking place in the public enterprise sector. As agreed with the World Bank, the measures being undertaken under parastatal sector reform are proceeding as planned.

In the agricultual sector, output is projected to show a slight expansion, reflecting a recovery from the adverse effects of the recent crop infestation. Similarly, with better pasture conditions, production of livestock is expected to increase so that the destocking of cattle that had occurred during the 1983-84 drought can be gradually reconstituted. As part of the reform of agricultural policies for promoting diversification, the authorities are re-examining research priorities and the restructuring of the agricultural research institute.

Because pricing and marketing policies constitute an important feature of the adjustment effort, the authorities are committed to continuing with the liberalization process as agreed with the World Bank and will take additional measures as planned. Furthermore, in support of he cautious fiscal stance being followed, the authorities are pursuing prudent monetary and credit policies aimed at enhancing the contribution of the private sector to the economy's growth prospects, containing inflationary pressures, and supporting the program's external objectives.

Niger's economic and financial adjustment during the past three years has been largely successful despite serious odds. Nevertheless, structural weaknesses that impede the long-term growth prospects of the economy remain, while the medium-term external position is projected to remain difficult. This situation calls for substantial and exceptional international financial support. It is the hope of the authorities, therefore, that bilateral and multilateral assistance, including debt relief, will be provided on concessional terms. Furthermore, the authorities are hopeful that the UNDP Round Table Meeting scheduled for early 1987 will raise the additional resources needed to enable them to finance the appropriate level of imports and thus improve the growth prospects of the economy.

Mrs. Ploix made the following statement:

I found several aspects of the staff paper on Niger's requests interesting. First, the paper brings out the very substantial progress achieved by Niger over three successive stand-by arrangements toward the adjustment of its economy; second, it underlines the authorities' clear commitment to continuing their efforts in the future; and third, it provides an interesting example of the slow but gradual process by which a country may evolve from strict adjustment to adjustment with growth.

Two of the major improvements recorded between 1982 and 1986 were that the central government deficit was reduced from 7.1 to 3.9 percent of GDP, and the external current account deficit was brought down from 9.7 to 2.2 percent of GDP.

The authorities' commitment to continuing this process is evident in the measures that they intend to implement during the course of the stand-by arrangement.

The first important aspect of the program is that a further reduction of the central government deficit is expected as a result of the tax measures previously introduced, while strict control of current expenditures will be maintained.

The second important area of this program is the intensification of the reform of the public enterprises. Besides the program of privatization or liquidation supported by the structural adjustment credit of the World Bank, the identification and settlement of cross-debts is one of the important elements of the rehabilitation of this sector.

Third, the liberalization of pricing and marketing policies, one of the key elements in the Government's adjustment policy, will be continued. On November 1, the number of products on the list subject to preset margins was reduced to 64. While that number may be high, the preset margin system is a fairly flexible one within which importers may set and modify their prices according to the costs incurred. Importers are no longer obliged to seek the approval of their sales prices. We can therefore consider that Niger now has a fairly liberalized price system that does not present risks of distortion and that contributes to an improved environment for private sector activity.

As to the transition from adjustment to adjustment with growth, although Niger's medium-term growth figures are not particularly impressive, the staff report notes that without the planned structural measures real economic growth would average only 1.1 percent annually. Given its natural constraints, it is all the more necessary for Niger to continue to remove the structural rigidities or distortions that affect the development of its economy. Much progress has already been made in the past few years, and Niger is already experiencing some of the benefits of the measures implemented since 1983. However, the favorable effects of these structural measures will not be fully felt for a few years, as has been the case with the reforms aimed at improving the overall investment climate of the private sector. I have mainly in mind the reform of the public enterprises, the liberalization of trade and prices, and credit policies.

This is also the case with the policies related to the public investment program and its orientation toward directly productive sectors. In this respect, it is worth noting the increase of 12.7 percent in development expenditures for the 1986/87 budget. It would be helpful to have some additional comments from the staff on the orientation of this investment program and how it will contribute to expanding the productive capacity of the country.

In this context of adjustment and medium-term growth, the design of the medium-term policy framework is appropriate, as is the coordination of Fund and World Bank operations. Therefore, as in the case of Senegal, I very much welcome the simultaneous approval of a stand-by arrangement and the first-year program under the structural adjustment facility.

Regarding the macroeconomic policy framework, I was very interested by the presentation of several scenarios and also of GDP growth by sector that was provided for the first time, which gives a good indication of the sources of growth in Niger, namely, the rural and secondary sectors. It would be very useful if this kind of information could be provided in the policy framework papers for other countries.

Niger's medium-term policy framework makes it clear that sustainable economic growth is not an exogenous phenomenon. It is a long-term objective that will require the continuation of adjustment and structural policies during some more years. The programs before us demonstrate the commitment of the authorities to this difficult task. They deserve our commendation and also the continued financial support of the Fund, the World Bank, and bilateral donors. I fully support the proposed decisions and ask Mr. Mawakani to convey to his authorities our warmest wishes.

Mr. Ayales made the following statement:

The measures that the Nigerien authorities have adopted in the past few years to cope with the unfavorable circumstances affecting the economy of the country reflect an earnest and comprehensive attempt to lay the grounds for a sustainable increase in welfare. This impression has been confirmed in Mr. Mawakani's opening statement.

The slowdown of economic activity in Niger in the early 1980s was a result, among other things, of the fall in the price of uranium exports and the drought affecting agricultural production, as well as of the lack of adequate fiscal and monetary policies. The improvement in the balance of payments in 1986 is mostly a consequence of better weather and the fall in international oil prices. The economy, thus, can be characterized as highly vulnerable to exogenous factors, and structural reform is required to avoid recurrent crises. We believe that the program presented with the request for a stand-by arrangement and for arrangements under the structural adjustment facility is a good starting point for a solution to Niger's economic and financial problems.

The two areas which call for prompt adjustment--the fiscal deficit and the balance of payments disequilibrium--offer, unfortunately, very narrow scope for adjustment, given the narrow income tax base and the heavy burden imposed by the external debt. Because of these constraints, one should not expect a very fast recovery. In fact, according to the projections, real GDP in 1990 will still be below the level reached in 1981.

Data on public finances seem to indicate that, although government revenues have grown relatively fast--particularly tax revenue--the current ratio of tax revenue to GDP remains almost unchanged, at a level below that registered in 1982 and 1983. Therefore, even though the tax reform has resulted in a more neutral mechanism for generating revenue, it does not fully compensate for the reduction in the collection of trade taxes.

As to expenditures, the effort to increase the share of investment, or development costs, in the overall budget is commendable; however, it is important to consider the possibility of reducing some of these costs, particularly when the envisaged reform of the public enterprises gives place to a process of privatization and decentralization. The overall share of development expenditures in public spending is not only increasing, but relies increasingly on grants, thus making the accomplishment of the authorities' development objectives somewhat uncertain since they are more dependent on the availability of foreign financial aid. As already suggested by Mrs. Ploix, the staff should comment briefly on the possibility of further reducing public development expenditure and of substituting grants with direct foreign investment, which would simultaneously alleviate both the public finances problem and the balance of payments disequilibrium.

The considerations arguing for a more pronounced fiscal adjustment stem from the fact that overall interest payments on the public debt do not account for more than 25 percent of the budget deficit, so that the solution to the debt problem does not constitute per se an answer to the fiscal problem. It is of concern that deficit financing comes mostly from foreign sources, thereby aggravating the foreign debt problems. If, in the future, foreign credit is not available, the Government could be forced to resort to inflationary financing or to impose new taxes that though yielding higher revenue may impair the progress made so far in fiscal policy.

As to the debt and debt service issue, I wonder whether the staff could shed some light on Tables 3 and 6 of Appendix VII of the staff paper, which indicate that the external debt outstanding as a proportion of GDP will fall from an estimated value of 59.3 percent in 1986 to 46.6 percent in 1990. Debt interest payments will fall from CFAF 18.3 billion in the 1986/87 program to CFAF 13.1 billion in the 1989/90 program. The staff paper is not clear as to how this trend--desirable in itself--can be attained. This is perhaps one of the most critical issues for overcoming the current growth-inhibiting situation.

As to the external sector accounts, the program has been designed on the assumption of a recovery in international uranium prices; however, the scenarios presented in the staff paper indicate sensitivity of the outcome to the terms of trade. It might be advisable to relate the adjustment measures explicitly to the terms of trade, which would require a higher degree of flexibility in implementing the program. This observation is particularly pertinent given that at the end of the adjustment period, imports in nominal terms will still be below their average value in the period 1982-85. Thus, the expected growth of imports is quite likely to occur. However, exports would have to grow through 1990 at a compounded rate of about 5.5 percent annually, a rate that might be difficult to attain, since revenue from uranium exports, which amounts to approximately 80 percent of total exports, is projected to grow only at a rate of 3 percent a year. In this way, the brunt of the effort will fall on nontraditional exports.

In conclusion, we find this adjustment program a very appropriate starting point for the solution of Niger's economic and financial problems. Therefore, we fully support the proposed decisions and wish the authorities success in the implementation of the program.

Mr. Kabbaj made the following statement:

I would like to support the request by Niger for a one-year stand-by arrangement, together with a three-year arrangement under the structural adjustment facility. Since I am in broad agreement with the staff appraisal, I shall limit my comments to a few points.

The economy is highly vulnerable to exogenous factors. Since 1983, the authorities have embarked on a comprehensive adjustment program with the support of the Fund under three successive stand-by arrangements to remove structural imbalances in the economy that had resulted from a weakening in the world demand for uranium, worsening terms of trade, unfavorable weather conditions, and a decrease in foreign aid. Increasing structural problems in the public enterprise sector had also led to further deterioration of the economy.

Notwithstanding Niger's deep-rooted natural and structural constraints, it is encouraging to note that all performance criteria under previous and current arrangements were met, and that the effective implementation of measures had positive results in reducing domestic and external imbalances and in aligning aggregate demand with available resources. Despite the difficult conditions that Niger had faced under previous arrangements and stagnation in the export price of uranium, the outcome for 1986 seems to be more favorable than expected owing to an improvement in weather conditions, the reopening of the border with Nigeria, and encouraging developments in the oil market. The progress achieved in the public enterprise sector, together with implementation of tight fiscal and monetary policies, has made a considerable contribution to the attainment of objectives envisaged under the program.

As a consequence of those developments, the economy made satisfactory progress in its financial performance in 1986. The current account deficit is estimated to decline from 3.6 percent of GDP in 1985 to 2.2 percent because the less than targeted increases in export receipts were more than offset by a 27 percent fall in import payments. The budget deficit is expected to narrow by 1 percentage point to 3.9 percent of GDP. The rate of inflation abated to 6 percent in 1986 from 7.5 percent in 1985.

Debt relief provided through the rescheduling of part of Niger's foreign debt obligations helped finance the overall balance of payments deficit. It should be noted, however, that debt relief was costly because it was obtained on nonconcessional terms. Reliance on this type of rescheduling is likely to jeopardize the economy's growth-oriented strategy in the medium term. Nevertheless, I welcome the authorities' effort to continue their prudent debt management policy, under which they committed themselves not to contract or guarantee any nonconcessional loans with a maturity range of less than 12 years.

Despite the encouraging financial improvements, it is worth mentioning that the budget and external account deficits remain unsustainable. It is clear that in view of the scarcity of domestic resources, the implementation of the public investment program continues to depend heavily on external concessional financing. Any initiative to reduce the economy's heavy reliance on foreign loans in order to mitigate the debt service burden would be a step in the right direction. In this context, I commend the authorities for their efforts in implementing the three-year rolling public investment program that would redirect investments toward productive sectors and reduce reliance on loans by financing a higher proportion of investment expenditures through foreign grants. In addition to the Government's endeavor, the situation calls for a further active contribution by donor countries in providing financial assistance through grants or on highly concessional terms.

Generally, the medium-term scenarios presented in the staff paper indicate that Niger still has far to go in laying the basis for achieving a sustained rate of economic growth higher than that of population growth, which would lead to an improvement in the country's standard of living and a viable balance of payments position that would establish orderly relations with its creditors. Given the financing gap envisaged in the staff's scenarios, it should again be noted that without the active participation of donor countries, it appears that the adjustment measures will be very difficult to implement, and the objectives envisaged in the medium-term program, therefore, will be as difficult to attain.

Mr. Hubloue made the following statement:

I welcome today's discussion, which gives us the opportunity to approve an arrangement under the structural adjustment facility for one of the neediest countries in sub-Saharan Africa. Against the very bleak external and internal background, the Nigerien authorities have been implementing, since 1983, a rigorous adjustment program that has gradually been complemented by the introduction of supply-oriented measures. The fact that all the measures envisaged under previous programs have been implemented and all performance criteria have been met underlines the authorities' determination to succeed; the present embodiment of these efforts in a clear medium-term framework aimed at the mutually supportive achievement of internal growth and external adjustment should reinforce that determination.

Nonetheless, despite all the adjustment efforts made thus far and those planned under the proposed programs, the simultaneous achievement of sustained growth and a viable balance of payments position will continue to depend greatly on exogenous developments, as illustrated by the alternative medium-term scenarios presented on page 19 of the staff paper. These scenarios show that under less optimistic assumptions for uranium prices, Niger will continue to be forced to make an undesirable choice between growth and adjustment. They also demonstrate that if we assume that uranium prices will remain at their present level, the readaptation of domestic policies required to achieve balance of payments viability by 1990 will nearly halve the additional growth impetus expected from the structural adjustment program. The scenarios show that in economies that suffer from severe natural constraints and low absorptive capacity--like most of the other economies of sub-Saharan Africa--the prospects for the success of growth-oriented adjustment remain quite limited notwithstanding the determination of the authorities. Perhaps additional research is still needed to help these countries design viable adjustment programs.

It is clear that the progressive elimination of the structural problems listed in the staff report will improve the efficiency with which available resources can be mobilized and allocated, and will loosen this constraint somewhat. However, in order to improve long-term growth prospects, it will be necessary to devise an investment strategy that addresses the long-term development problems of the country without endangering its progress toward external and internal financial stability.

In this connection, I warmly welcome the authorities' intention to concentrate their investment programs on projects that are suitable for financing through foreign grants to reduce Niger's reliance on external loans. Given the heavy debt service burden inherited from past external policies, Niger will indeed have to adopt prudent debt management in the years ahead. The present emphasis on concessional financing as the cornerstone of Niger's investment program is an essential element in the country's financial stabilization process. Another crucial element of

Niger's investment strategy is the choice it makes between long- and medium-term development goals. As in many central African economies, Niger's long-term development constraints stem from its lack of human resources and the meager resource base for agricultural production, while more immediate income-related concerns force it to redirect investment resources toward the directly productive sectors of the economy. Although this may not be the place to discuss development strategy in detail, some comments from the World Bank representative on the likelihood of such a strategy alleviating Niger's development constraints over the long term would be welcome.

One means of relieving the tightness of the choice between short- and medium-term development objectives would be to intensify efforts to free domestic resources for productive activities. In this connection, the Fund program rightly focuses on reducing the financial burden on the economy of the large public enterprise sector and on further liberalizing the economy. I note from the summary description and the timetable of the various structural adjustment policies on page 14 of the staff paper that although some of these policies have been assigned a very tight and precise timetable, the implementation schedule for other policies is looser and covers a period of three or four years. In my view, such long implementation periods may place at risk the program's full effectiveness. Perhaps the envisaged rationalization of incentive measures and tax policies to improve the efficiency of the public enterprises should be speeded up; because there will still be 25 of these enterprises after the present reform process is complete, they will continue to have a significant effect on domestic resource allocation. Also, it is not yet clear to what extent the ongoing reform process will result in the financial autonomy of the public enterprises. Some comment from the staff on these issues would be welcome.

Another issue on which I would like to have the staff's views is the likelihood that the marked reduction of the public sector borrowing requirement (PSBR) will provide for a corresponding expansion of credit to the private sector, which at our discussion on the previous Article IV consultation for Niger (EBM/86/99, 6/20/86) was found to be an essential element in achieving higher growth over the medium term.

Niger's adjustment program continues to address carefully and appropriately both the financial and natural constraints affecting the country and the need to focus increasingly on supply-oriented policies. The authorities are to be commended for their firm commitment to this difficult course of action. Therefore, I fully support their requests for a new stand-by arrangement and for an arrangement under the structural adjustment facility.

I would like to make a comment of a more general nature regarding our discussions on the structural adjustment facility. Although the first review of our experience with this new facility will not take place before March 1987, I have the impression from the cases presented thus far that our discussions of medium-term policy frameworks could be made more productive if the staffs of the Fund and the Bank would include a brief but frank assessment of the validity of the economic strategy presented in the policy frameworks in terms of its impact on the growth and adjustment prospects of the country. Perhaps this suggestion could be examined in more detail in the course of our forthcoming review of the structural adjustment facility.

Mr. Goos made the following statement:

We feel that the economic program underlying the requests before us constitutes a commendable and, indeed, promising effort to further improve the country's economic prospects. Therefore, and in view of the excellent track record under the previous Fund arrangements, I support the proposed decisions. Since I am in broad agreement with the staff appraisal, I will limit myself to only a few comments.

One particularly worrisome feature in Niger's economic performance, which drew the attention of previous speakers and also attracted special attention at the World Bank's Board discussion, is the very dim growth prospects over the medium term. Those prospects are clearly a matter for serious concern, the more so since we learn from the staff report that "the full effect of the wide-ranging measures that have been implemented (so far) will be felt only over the long run." This assessment, which is directly related to the intricacy of the country's structural problems caused largely by natural constraints, clearly points to the following conclusions. First, it underlines the urgency of concentrating all available forces on the resolution of the policy-related structural deficiencies. Although the authorities' efforts in this regard are most impressive, we, like Mr. Hubloue, have some doubts about the appropriateness of the time frame envisaged for some of the liberalization measures. This is particularly true for the deregulation of pricing policies, which will be completed only by 1990, and also the rather extended period envisaged for the liberalization of the grain market. In the same vein, I feel that the authorities should aim at a lower inflation rate than the one expected under the program, while at the same time adopting a more aggressive and direct approach toward stimulating private domestic savings by setting appropriate incentives, including attractive interest rates. More forceful measures in those areas could indeed provide an additional stimulus to economic activity. Nevertheless, there would probably be no assurance of a lasting reversal in the declining trend in living standards, particularly in view of Niger's vulnerability to external shocks. Such dismaying prospects undoubtedly require the continued support of the international community and suggest that the authorities should give early consideration to a more active policy of population control, which obviously does not fall within the Fund's mandate.

The second conclusion to be drawn from the serious natural constraints facing the country is the need to restrict external financing to the extent feasible to highly concessional funds and grants, a conclusion that also follows from the existence of a very high external debt service burden, as the staff has rightly stressed. Consistent with that view, I continue to believe that Fund financing out of regular resources, given its short- to medium-term nature, and the relatively high costs involved, can only be justified on a limited and exceptional scale. Therefore, I would like to welcome the scheduled reduction in the country's use of its credit tranche position over the program period, which appears to be in the best interest of Niger.

Mr. Al-Assaf made the following statement:

Since 1983, the Nigerien authorities have been implementing a series of adjustment programs supported by the use of Fund resources. These programs have been adopted against the background of both deteriorating markets for Niger's main export--uranium--and severe drought. What has been notable about the conduct of recent economic policy in Niger is not only that the authorities have persisted with their adjustment efforts in the face of this hostile background, but also that they have adapted and strengthened their policies to accommodate the adverse exogenous factors that emerged during the implementation of the program. I warmly commend the authorities for these efforts.

Unfortunately, although much has been achieved, much more remains to be done. The staff paper details the structural impediments that remain in the areas of public resource management, the public enterprise sector, and the institutional framework which have affected savings and investment decisions. The authorities' awareness of these impediments is commendable, as is their intention to address them within the context of the medium-term approach offered by the structural adjustment arrangement.

Given its circumstances, Niger's prospects for immediate growth are not very favorable. The country faces severe financing constraints over the next few years, owing to the low domestic saving rate and the already high debt service ratio. Further, the structural measures that they have adopted--and those that they intend to adopt--will take time to bear fruit. In addition, Niger is still adjusting to a sharp decline in the price of uranium and to a serious drought. Such shocks mean that, ideally, the authorities first need to bring the economy to a manageable level before it can embark on a path of sustained growth. It must also be recognized that although the projected growth rates are low, if the alternative course of avoiding structural policy reforms is chosen, the outcome, as the staff points out, would be worse. It is in this context that I support the proposed stand-by and structural adjustment arrangements.

Despite the discouraging outlook for growth, there is some possibility that the growth rate could accelerate. I note that fiscal policy might be relaxed if greater than anticipated external financing is available on appropriate terms. If this turns out to be true, it would be desirable to increase government expenditure on productive investment projects that would enhance the productive capacity of the economy. It might even be desirable if, at the same time, higher expenditure is targeted to help the poorer section of the population, which could also support the adjustment process. However, I would be very reluctant to endorse further increases in unproductive administrative expenditures.

I commend the authorities for the tax reforms that they have already implemented. The introduction of a value-added tax represents a welcome broadening of the tax base. However, I am puzzled about the continued inelasticity of the tax system, despite the many reforms. I wonder whether this is not due to the fact that the tax system remains fragmented and contains many discretionary elements. I note from the tax summary in the most recent background paper on recent economic developments that Niger retains a schedular income tax and that many of the other taxes have numerous exemptions. The problem is that features such as these often tend to result in lax revenue collection and in an erosion of taxpayer morale. Experience in other countries suggests that reforms in these areas can reverse such effects and thereby enhance tax elasticity and tax revenues by broadening the tax base and facilitating tax administration. Therefore, I welcome the intention of the authorities to undertake a review of the tax system.

As to agricultural policy, I agree with the staff that comprehensive reform of this sector is an essential element of the adjustment program. Diversification of agricultural production will be central to any improvement in Niger's economic prospects. In this connection, I welcome the authorities' intention to review the rural development strategy. I also welcome the World Bank's involvement in this exercise. However, because of Niger's circumstances, I would urge that as in other areas, proposed studies be translated into actual policies as rapidly as possible.

I am encouraged by the anticipated strengthening of Niger's external sector position. I understand from the latest information available that Niger's real effective exchange rate continues to depreciate, in marked contrast to some of the other countries in the West African Monetary Union. Given that Niger conducts a significant share of its trade with neighboring countries, this trend should facilitate increased exports. In the same context, I commend the authorities for the fact that the rate of inflation, at least as measured by movements in consumer prices, has come down to low levels, where I hope that it will remain, although I recognize that it could be influenced by further price liberalization.

In conclusion, I commend the authorities for all that they have achieved. They have demonstrated their persistence and courage in the face of difficult circumstances. Further, as pointed out in Mr. Mawakani's opening statement, they remain committed to a policy of adjustment. I believe that the proposed stand-by and structural adjustment arrangements deserve Fund support and I support the proposed decisions.

Mr. Dallara made the following statement:

On the whole, Niger has made a commendable effort over the past few years to implement an economic program that has increasingly addressed structural problems as well as financial imbalances. Although this effort has produced some progress, the experience of the past few years has demonstrated that Niger's problems are deep seated and that its limited natural resource base, the weakness of the uranium market, and the vulnerability of the agricultural sector to weather, as well as other factors, require an intensive effort on the part of the authorities to mobilize the domestic factors of production and to attract external financing. Therefore, in our view, Niger cannot afford an inefficient economic structure or policies that do not maximize to the extent feasible the productive potential of the economy. A corollary to that is the urgency of the adjustment effort needed for Niger to achieve satisfactory growth during the years ahead.

In our view, the program set forth by Niger, supported by the Fund through both a stand-by and a structural adjustment arrangement and by the World Bank through a structural adjustment credit--all in the medium-term context set forth in the policy framework paper--is, on the whole, a sound program. We commend the Fund and Bank staffs for their constructive, supportive, and collaborative role in the development of this program. However, we are left with the sense that, despite the authorities' stated objective of mobilizing private sector resources and a number of important measures taken to that end, more can be done to mobilize private resources in the agricultural, commercial, and industrial sectors--perhaps more than is now clearly outlined in the medium-term framework.

A great deal of well-placed attention has been given to the public sector investment program. We believe that the plan in this area seems particularly constructive, but we are not sure that an equal amount of attention has been given to the measures that will stimulate private sector investment. We hope that this question will be given considerable thought and attention by the authorities and the staff in the context of the World Bank's continuing efforts, the midterm review of the Fund's stand-by arrangement, and the formulation of program measures in 1987 under the structural adjustment arrangement.

Although the staff paper is thorough in its presentation of the adjustment measures, it does not place the measures in an appropriate context and provide some analytical perspective on the importance of specific measures. For example, the staff paper states exactly which firms have been, and are being, privatized, but it is not clear whether these enterprises represent the bulk of the public sector. The status of the 25 enterprises that will apparently remain is also unclear. In other areas, there is similar information that, although helpful, is unclear about the overall relative importance of the measures being taken. In the next staff paper, it would be useful if greater contextual and analytical information could be provided to help the Board assess the relative importance of the measures being taken.

With respect to tax reform, although we recognize that measures have been taken with the basic objective of enhancing tax elasticity, we wonder whether there is not a need for tax changes to focus on producer incentives. Where do producer incentives fit into tax reform? We would welcome any information that the staff or Mr. Mawakani may have; or perhaps the issue is simply one that could be reflected upon by the authorities as they move ahead in developing a broader tax reform program.

We consider that the level of access under the stand-by arrangement is appropriate. While we did note the discussion on page 20 of the staff paper of Niger's ability to repay the Fund, we would welcome more information, particularly in the light of the comments on page 11 that, "notwithstanding the adjustment achieved thus far, both the budgetary and balance of payments positions remain unsustainable."

We are concerned about the lack of comparable treatment granted by some of Niger's creditors in debt rescheduling. We appreciate the authorities' efforts to deal with this problem, and wonder whether the staff can provide information about those creditors who have not participated in comparable arrangements and whether there are Fund members among them. It would also be helpful to know whether the staff could facilitate the resolution of this problem.

We welcome the strong World Bank support for Niger's adjustment efforts, but would have appreciated more information in the policy framework paper: first, on the Bank's planned funding levels during the outer years of the medium-term framework; and second, on the policy areas in which the Bank plans to concentrate in the period ahead.

We note from Table 1 of the staff paper that Niger has experienced real effective depreciation of its exchange rate over the past years, in part due to relatively low inflation rates. We also recognize that numerous benefits accrue to Niger, as well as other members of the West African Monetary Union, in terms of financial stability and restraint on central bank funding of government deficits. Nonetheless, we wonder if in the context of the weak overall balance of payments and the need to stimulate exports and contain demand in the most efficient manner, some consideration should not have been given to the question of the exchange rate. There is virtually no discussion of this issue in the entire staff paper. Exchange rate policy is a relatively important pricing tool, albeit one in this case that is dealt with within the context of broader considerations than Niger's own circumstances. We recognize that it is a sensitive issue and that Niger benefits in many direct and indirect ways from its participation in the Monetary Union. However, I believe that it is perhaps the Fund's role to keep the analytical process alive on these issues so that one does not become too comfortable with the arrangements that are currently in place.

The staff paper forecasts an annual export volume growth in the medium term of 1.4 percent. In our opinion, this is of serious concern. We recognize that the very limited domestic resource base may be the major constraint on Niger's export growth capacity; nevertheless, we wonder whether there is some scope for promoting expansion in the resource base, for cost-effective import substitution, and for diversification in part through the exchange rate. We would welcome any comments the staff may have.

Another area that we were particularly interested in was pricing in general--pricing other than the exchange rate. We note favorably that the agricultural pricing and marketing systems have been substantially liberalized and that this should over time provide the foundation for more rapid growth. Apparently, the Government no longer sets producer prices, and an increased role for small-scale private trading intermediaries is being encouraged. Furthermore, the Government is increasing credit availability to farmers. Although this progress is indeed welcome, we are concerned by certain aspects of pricing policies as outlined in the staff paper. In part, as Mr. Hubloue and others have noted, we have had the feeling that the pace of structural adjustment should have been more aggressive. We understand that there will be a phased liberalization of the price controls by 1990; however, we have not been informed of any specific measures envisaged for the next 12 months beyond those that have been taken recently. We recognize that to an extent these may have been prior actions. Thus, we are somewhat at a disadvantage in assessing the importance of the pricing changes that have been taken. The staff paper states that the number of items on the list of imported products currently subject to pre-set profit margins has been reduced from 200 to 64. How much of import volume does this represent? Are the products among the more important imports? What is the structure of those imported products that have been left subject to margins and those which have been freed from margin control? Those that have been left are subject to margins of 35 percent and 50 percent, which at first glance seem rather high. We would welcome comments from the staff or Mr. Mawakani on this issue.

We would encourage the authorities to be aggressive about the pace of adjustment. In the light of the exchange rate regime, it seems critical that if relative price changes are needed in order to stimulate production in the very difficult circumstances that Niger faces, action should be taken at the earliest stage possible.

We would like to reiterate our support for this program and for Niger's adjustment efforts in a very difficult environment, at the same time underscoring the need for timely action--in some areas, more timely than planned--in order that Niger can achieve higher levels of growth in the context of a viable payments position.

Mr. Fox made the following statement:

Other speakers have described Niger's success--against a difficult background--in reducing financial imbalances over the past few years largely as a consequence of the authorities' commitment to the process of adjustment and their determination to offset deteriorating external conditions, as demonstrated by the promptness with which measures have been taken. An important start has also been made in structural areas such as price liberalization and public enterprise reform. The authorities' program for the next three years, as outlined in the policy framework paper, continues in the direction of previous years and is to be welcomed, together with the stand-by arrangement that specifies policies for the first year under the program.

Although further significant progress in reducing financial imbalances is discernible over the time frame of the policy framework paper--always assuming, of course, that its assumptions prove to be valid--the economy's growth performance still seems somewhat disappointing, with per capita incomes barely rising by the end of the program period. I would welcome staff views on how this performance might be improved, taking into account the constraint imposed by the heavy debt burden.

Two important areas of economic performance are particularly disappointing. First, in volume terms, exports have fallen by over 25 percent since 1981 and are not expected to grow much over the rest of this decade. Yet an improvement in export performance is crucial to the authorities' efforts to achieve a faster and sustainable rate of growth. The weak prospects for uranium exports is one factor holding back overall export performance. But nonuranium exports have also been weak. Niger, like Senegal, has a fixed exchange rate; unlike Senegal, the real exchange rate in Niger has been declining. Nevertheless, like Mr. Dallara, I would have welcomed some discussion of the effects of real exchange rate movements on Niger's export performance. The staff paper describes the recent appreciation of the CFA franc against the dollar as a positive factor, presumably for its effect on inflation, without discussing the implications for exports, which actually or potentially cannot all be within the franc zone. I would also have welcomed some elaboration of alternative policies to be pursued toward the objective of enhancing competitiveness and expanding the export base and encouraging import substitution as referred to on page 12 of the staff paper.

The second disappointing aspect of Niger's recent economic performance has been the sluggishness of domestic savings, especially against the background of a sensible interest rate policy. As other speakers have noted, despite the implementation of a number of discretionary tax changes, revenues in the public sector have been falling as a percentage of GDP and are not expected to show much improvement even by the end of the decade. To some extent, this reflects the sharp fall in import volume over the past few years, but it is disappointing that efforts in this area have apparently met with so little success. An important factor in promoting public savings will be progress in the public enterprise sector and I would encourage the authorities to press ahead with their reforms in this area.

In the area of price liberalization, the additional measures proposed are welcome. However, even after the changes that will be introduced shortly, the system will remain complex, classifying products and services into five different categories and setting either ceilings on the level or increase in prices or different profit margins for each. Presumably, this system requires an extensive bureaucracy to administer. I note, too, that even the intended price liberalization is not expected to be completed until 1990. Therefore, like Mr. Goos and Mr. Dallara, I urge the authorities to consider moving faster in this area.

I note the comment in the staff paper that the external sector position will be viable by 1990. One hopes that this will be so. But growth under this scenario would still be constrained to not much, if anything, above the rate of population growth. The policies that the authorities are pursuing are undoubtedly in the right direction. However, I would join those other speakers who have encouraged the authorities to contemplate a more vigorous pace of reform, bearing in mind that the faster reforms are implemented, the faster improvements will materialize. As one small example of how modestly some key reforms have moved to date, it is surprising indeed that it will be nearly four years after the beginning of the latest round of adjustment efforts before a study of civil service reform will be completed. Expenditures on personnel account for over one third of the public sector's current budget. This is just one area where earlier action would have paid dividends.

I have no difficulty approving the program outright, given the likelihood that debt rescheduling will cover the 1987 financing gap. However, I would welcome any information staff may have on compliance with performance criteria at end-September. As to the structural adjustment arrangement, I found the presentation of the structural elements of the program and the timetable for their implementation to be clear and helpful. Although I have suggested that a faster pace of reform in certain areas should be considered, the presentation in the staff paper showing that a minimum of three years will be needed overall, and that much will remain to be done after the first year of the structural adjustment arrangement is rather more realistic than some of the timetables we have seen so far.

Mr. Dreizzen made the following statement:

Like other Directors, I would like to commend the Nigerien authorities for the progress achieved in reducing the country's external and internal imbalances under the three successive stand-by arrangements since 1983. Niger has implemented a comprehensive set of policies under these programs and has an outstanding record in its observance of performance criteria.

The external current account deficit declined sharply from 9.7 percent of GDP in 1982 to 2.2 percent in 1986, monetary expansion was brought under control, and the central government deficit on a commitment basis declined by almost one half. The rate of inflation has come down, and there has been some recovery in economic activity during the last two years.

The authorities have demonstrated their full commitment to pursue the needed measures. Therefore, they deserve financial and technical support from the Fund and other multilateral agencies, as well as from foreign official and private creditors. In this respect, we agree with the staff appraisal on the need to assure a timely disbursement of the envisaged financial assistance to secure the continuation of an orderly process in Niger.

The new program for 1987 includes a strict fiscal policy that will not permit any increase in net domestic credit to the Government. This policy will contribute to further progress in the elimination of internal and external imbalances; at the same time, it will allow the private sector to obtain enough credit resources to finance the increasing role assigned to it in the three-year structural adjustment plan.

With regard to the medium-term outlook of Niger's economy, despite all the efforts and comprehensive set of measures envisaged under the structural adjustment program, the savings rate will remain at a low level. This phenomenon, together with the weak resource base and the high rate of population growth, constitutes a serious structural constraint to achieving a rate of growth high enough to reverse the sharp decline in living standards that has taken place in Niger.

In this connection, we are concerned that even under the assumption that all the medium-term policy targets will be met, GDP is projected to grow at 2.1 percent a year until 1990 compared with a rate of population growth of 2.8 percent. This means that real GDP per capita will continue to decline during the rest of this decade.

Moreover, the success of the three-year program will depend heavily on two risky factors that are beyond the direct control of the Government: the international environment and the response of a weak private sector. It is very illustrative to see the high sensitivity of medium-term balance of payments scenarios to developments in the rest of the world, and particularly to the evolution of the uranium market. With regard to the private sector response--an issue raised by other Directors I understand that except for agriculture, there are very few private entrepreneurs and that the sensitivity of their expectations and investment decisions to an improved environment may be too volatile to be forecasted. Some comments by the staff on the private sector's present situation and its future prospects would be welcome.

One of the major structural problems that the authorities have to face is the lack of qualified and skilled manpower because of the low rate of primary education enrollment. According to the last paragraph on page 27 of the staff paper, it seems that there will be a shift of expenditures from scholarships to the maintenance of education facilities. It would be useful to have some comments from the staff, or perhaps from the World Bank representative, on the policies envisaged under the structural adjustment facility regarding the development of human resources.

In conclusion, the authorities' future task is not easy; however, they have demonstrated their firm commitment to reducing the country's imbalances and to pursuing the right structural policies in order to strengthen its economic base. They deserve the assistance of the Fund and the international community.

I support the proposed decisions and ask Mr. Mawakani to convey to his authorities the best wishes of this chair on the implementation of the program.

Mr. Mustafa made the following statement:

Economic conditions in Niger deteriorated significantly in the early 1980s due to a number of adverse developments, including a decline in the terms of trade and unfavorable weather conditions. The situation was further aggravated by the pursuit of expansionary financial policies and other inadequate economic policies. Policy action to correct the imbalances that developed was initiated in 1983, and since that time the authorities have carried out a rigorous economic adjustment effort supported by three stand-by arrangements from the Fund. As the staff paper indicates, all measures envisaged under these programs were implemented and all performance criteria were met. The authorities established this good record of implementation by strengthening adjustment policies whenever it was necessary to mitigate the impact of unforeseen adverse developments. The adjustment undertaken so far has already helped to narrow financial imbalances and ease structural constraints, and further benefits are expected over the long run. Moreover, adjustment efforts have been aided recently by some favorable external developments which led to improving the economic outcome in several respects beyond what was envisaged under the current stand-by arrangement.

Notwithstanding the progress already made, the structural and financial imbalances that remain undoubtedly call for maintaining strong adjustment efforts to achieve a sustainable adequate rate of growth and a viable external position. The medium-term policy framework paper has identified the adjustment policies needed to achieve these objectives by 1990 in the context of a three-year program. Financial policies under the program are to be tightened to limit the growth of aggregate demand, but the degree of tightening, as indicated by the staff analysis, is to be compatible with some expansion in economic activity. Another important element of the medium-term adjustment strategy is the three-year rolling public investment program that the authorities introduced in cooperation with the World Bank. The implementation and financing of the program will be monitored to ensure that it contributes to reducing the debt service burden while promoting growth. The ongoing reform of public enterprises is to continue with the objective of reducing the scope of the sector and increasing the efficiency of enterprises. The set of structural policies also includes a strengthening of the incentive system and a phasing of price controls. Agricultural policies are directed toward promoting the private sector through greater reliance on liberal marketing and pricing policies. As the medium-term scenarios prepared by the staff indicate, the implementation of the policies envisaged and their strengthening in the event of unforseen adverse developments are likely to lay the basis for the attainment of sustained growth and balance of payments viability.

The economic and financial program, comprising the proposed stand-by arrangement and the first annual program under the structural adjustment facility, is formulated in the context of the three-year program, and includes a wide range of adjustment measures aimed at achieving significant progress toward the aforementioned medium-term targets. On the supply side, there are measures relating to public resource management, incentive policies, public enterprises, agricultural policy, and financial system reforms. On the demand side, the proposed economic and financial program involves a further reduction in the budget deficit, a reduction of cross-debts of the public sector, a tight credit policy, and a cautious external debt management policy. The nature and scope of the proposed economic and financial program amount to a significant adjustment effort, and testify to the continued commitment of the authorities to undertaking needed adjustment. I can, therefore, support the proposed decisions.

An important objective of arrangements under the structural adjustment facility is to promote economic growth in low income countries while pursuing financial stabilization. Niger's three-year program envisages limited increases in economic growth, and the rate projected for 1990 barely exceeds the rate of population growth. Further efforts are clearly needed to strengthen domestic resource mobilization and to attract further concessionary foreign resources to support higher economic growth that will turn around the significant deterioration in standards of living that has taken place over recent years. In this context, it should be noted that the proposed adjustment efforts entail only marginal increases in the savings and investment ratios to GDP, and that only limited growth is projected in the volume of commodity exports. Increases in tax revenues as a percent of GDP under the program are also marginal, despite the tax reform already undertaken. Thus, consideration should be given to the introduction of supplementary policy measures to strengthen the growth orientation of the proposed adjustment effort.

Mr. Munthali made the following statement:

Since I am in broad agreement with the staff appraisal, I will limit my intervention to a few general comments. I believe that the thrust of both the short- and the medium-term adjustment programs to be supported by a stand-by arrangement and the structural adjustment arrangements, respectively, is in my view in the right direction. In any event, these programs are a logical follow-up to the programs that the authorities have implemented to date and to which we all lent our full support.

The staff paper provides somber reading because it is very candid about the extremely difficult structural problems that the country now faces and ones that it is likely to encounter in the medium-term period. Despite concerted efforts by the authorities to resolve those problems through successive adjustment programs, the problems appear to persist. The medium-term baseline scenario does not provide much ground for optimism. Indeed, there appears to be a general recognition that Niger will experience stagnation or even a decline in per capita income over the medium term. This appears to be the inevitable consequence of the severe constraints to economic growth and the measures being implemented, designed to achieve sustainable growth in the long run. Although this is likely to be frustrating for the authorities, I believe that they do not have a better alternative.

In a way, some would tend to think that the low level of economic growth projected for the medium term in the baseline scenario should be viewed as a cost that the Nigerien people should legitimately bear in order to put the economy back on a sustainable growth path following the pursuit of inappropriate policies in the past. However, for a sympathetic observer, a scenario that involves a persistent decline in per capita income may be seen as too much of a cost because certain exogenous factors--completely outside the control of the authorities--have contributed significantly to the present situation of the economy. One needs only to cite the stagnant world market for uranium and the adverse weather conditions that have had deleterious effects on the economy. Furthermore, the natural constraints mentioned on page 11 of the staff paper provide ample evidence of the kind of problems that the economy has been facing. Therefore, it is difficult to know whether the baseline scenario provides for adequate expansion to enable the economy to resume debt servicing without recourse to rescheduling.

At the same time, one does recognize that it is difficult to plan for a rapid expansion of economic activity without aggravating financial imbalances in the economy. In any event, this would require a careful selection of investment projects, together with additional foreign assistance on highly concessional terms. Given the general outlook for external assistance, I believe that not much can be achieved to mobilize enough additional assistance to support an expanded development program. In the circumstances, I concur with the stance adopted by the authorities of continuing to emphasize strong demand management policies while fostering structural adjustment measures designed to promote economic efficiency. I have every confidence that the authorities will implement the program in full, given the encouraging track record that has been established under the past three stand-by arrangements.

Finally, I note that quantitative ceilings under the stand-by arrangement will also serve as benchmarks for monitoring performance under the structural adjustment arrangement. Furthermore, other benchmarks covering a wide range of areas have been established. Some of these coincide with what the World Bank has established under its own program of assistance. I believe that this is inevitable if the objectives of the programs are similar. However, the issue is that Niger is being required to undertake a very strong and extensive adjustment program, and in my view the amount of assistance is rather small for such an effort. Perhaps what is more worrisome is the fact that the total amount of resources mobilized to support these efforts does not even aim at maintaining the level of per capita income. In other words, the amount of resources available does not provide adequate encouragement to the authorities that sustainable growth will be achieved in the medium term. I believe that the program should have been designed at the miminum so as to maintain the level of real per capita income; this would have been in line with the spirit of the structural adjustment facility.

I support the proposed decisions and ask Mr. Mawakani to convey to his authorities the best wishes of this chair.

Mr. Vasudevan made the following statement:

We have admired the recent efforts of the authorities of Niger in bringing about viable external and economic adjustment, and supported the requests for stand-by arrangements in the past.

The staff paper has given an excellent account of the progress made since 1983 in different areas of policy. Mr. Mawakani's opening statement has reinforced the staff's account. However, we feel that the growth rate has to be raised further and that this increase needs to be obtained by an array of economic policies. Obviously, the structural aspects of the policy package will have to receive special emphasis, both in terms of the analytics of the transmission mechanism and of a well-articulated model of a mechanism on which to base the implementation of the package. The statement on page 12 of the staff paper that, "without the structural measures, real economic growth would average 1.1 percent annually during 1987-95," implies that the staff has made a study of the effects of different structural measures on growth rates over as long a period as eight years. I wonder whether there has been a detailed study, and if so, whether any of the results--at least in rudimentary form--could be given to the Board. Such a study could be provided as an appendix to one of the forthcoming staff papers.

I am concerned about the evolution of the three-year rolling public investment plan, which was mentioned on page 13 of the staff paper. The plan gives the impression that although investment programming has to be strengthened to achieve even a modest average annual growth rate of 2.1 percent during 1987-90, investments could well decline if finances were not available. It would be a pity if the growth rate were allowed to fall below the targeted rate for lack of adequate finances. We would support any efforts that the Fund and Bank could make to catalyze resources and obtain concessional resources for Niger.

Notwithstanding these remarks, we support the requests for the stand-by and structural adjustment arrangements that, as many other Directors have pointed out, are needed for a country that has been making excellent adjustment efforts ever since 1983. Besides, the programs are strong ones and their implementation will reduce the possible adverse effects that exogenous factors may have on the external payments position.

The benchmarks set under the structural adjustment arrangement are twofold. First, they reflect the quantitative performance criteria under the stand-by arrangement relating to domestic credit, the fiscal position, and external aspects. Second, there are an additional seven benchmarks, which cover all the policies described in paragraphs 15-25 of the letter of intent. Of course, benchmarks do not have any effect on the phasing of drawings or any other operational significance, because a stand-by arrangement is also in effect. But we believe that it might be best to take an integrated rather than a separate view when requests for both structural and stand-by arrangements are considered. We know that benchmarks are expected to monitor progress in policy implementation and in reaching the objectives of the program that have been outlined by the authorities. But we also know that benchmarks "will have to be constructed in a flexible way." Flexibility unfortunately suffers the moment one has too many objectives and too many aspects to be monitored. In this context, it would be useful to know what criteria the staff has adopted in determining the number of benchmarks to optimize the objective of "monitoring." Are there any theoretical or operational underpinnings in this regard?

We convey the best wishes of this chair to the authorities in their adjustment efforts.

Mr. Lim made the following statement:

For several years now, Niger--with the assistance of the Fund and Bank--has been undertaking widespread economic adjustment policies and structural reforms. Despite a somewhat mixed domestic and external environment over this period, all the measures included in the programs have been implemented and all performance criteria have been met to date. The authorities are to be commended for their efforts.

Under the current stand-by arrangement, which is to end next month, the authorities have blended restrictive financial and prudent debt management policies with significant reforms in pricing and marketing policies and the public enterprise sector. Together with World Bank assistance, they have improved the focus and reoriented the financing of investment activity.

The staff notes, however, that notwithstanding the authorities' adjustment efforts so far, the budgetary and balance of payments positions remain unsustainable; large financing gaps will have to be met over the next few years and significant reliance will be placed on debt relief. I have some concern about the authorities' dependence on debt rescheduling to meet their balance of payments financing gap. While debt rescheduling has proved necessary to meet short-term financing requirements, it merely defers the debt problem at a not inconsiderable cost. Indeed, the importance of maintaining the authorities' adjustment efforts is underlined by the World Bank's assessment that, in the absence of a structural adjustment program, Niger's growth prospects are a mere 1.1 percent a year in the period 1986-95.

Against this background, we welcome the authorities' commitment to firm domestic policy management and the implementation of further major reforms as outlined in the proposed stand-by and structural adjustment arrangements.

For 1986/87, the arrangements place emphasis on generating a favorable environment for fostering private sector economic activity, while maintaining restrictive financial policies. They generally build on and develop earlier policy initiatives. Reform of the public sector enterprises is to continue. In this connection, we welcome the further privatization and amalgamation of enterprises, the introduction of better management practices, and the identification and settlement of outstanding public cross-debts.

The authorities do not plan to introduce any new tax measures in 1986/87 following the implementation of recommended tax measures over the past two years. However, if the current evaluation of the recent tax measures and tax administration shows any deficiencies, we would expect that corrective actions would be considered as early as the first review, which has been scheduled for March 1987. We support the proposed expenditure policies. Expenditure control has assumed even greater importance now that additional revenue options are limited for the present, and given the importance of generating domestic savings, which are expected to be derived largely from public sector restraint. Caution in committing non-grant financing to investment projects will also be important in preventing expenditure slippages.

As to agricultural reforms, I note that the study of the promotion and diversification of agricultural production will not be completed before the end of 1988. I wonder if this important work could be advanced somewhat, and would welcome any comments from the staff or Mr. Mawakani.

One aspect of the program that causes me considerable unease is the projected pace of adjustment and reform, given the size of the external financing gaps to 1990, the narrow export base and the heavy dependence on uranium, the significant reliance on external grants, and the magnitude of the structural problems still evident.

The impression of gradualism is of course amplified by the extent of adjustment still needed and by the resource limitations that constrain a more rapid achievement of a sustainable external position. Nonetheless, the slower the return to sustainable domestic and external positions, the greater the susceptibility of the programs to either domestic slippages or adverse external developments. These risks are highlighted to some extent in the very useful medium-term scenarios produced by the staff.

The staff paper states in a number of places that studies are currently being conducted by the authorities. I would emphasize the importance of these studies being quickly translated into policy actions.

The staff paper does not seem to include much discussion about the prospects for further reductions in inflation. The rate of inflation is not projected to fall in 1987 from the level expected at end-1986. Indeed, the medium-term scenario assumes a constant GDP deflator of 6.0 percent to 1990. It would be useful if the staff commented on whether a faster reduction in the rate of inflation in 1986-87 and over the period to 1990 would be possible.

I agree with the staff's views on the level of access for this stand-by arrangement. The staff proposal is consistent with the current access policy, taking into account the adjustment required and the prospects for continued Fund involvement in Niger for some years to come. I would like to wish the authorities well and I support the proposed decisions.

The staff representative from the African Department observed that there were severe obstacles to achieving sustainable economic growth for Niger under conditions of domestic and external financial stability. Niger was a landlocked country. Arable land was estimated to be about 12 percent of total land area, and it was highly vulnerable to the weather, having suffered severely from recent droughts, which had resulted in serious degradation of the soil. Niger's human capital base was underdeveloped. Its major export commodity--uranium--had been affected very badly by the slack in the world uranium market.

Those obstacles had been exacerbated by a number of policy-related constraints, the staff representative remarked. First, there had been problems in public resource management that ongoing programs were attempting to resolve; those problems included the inelasticity of the tax base, imbalances in the structure of expenditure, and the lack of an adequate investment planning process. Although considerable progress in those areas had been made under the previous three stand-by arrangements, problems remained and needed to be addressed. Second, public enterprises had been characterized by weak management, serious undercapitalization, and an inadequate legal and institutional framework. Third, there were policy-related constraints in pricing and marketing arrangements; when Niger had initiated its programs with the Fund in 1983, there had been a wide array of price controls in effect, and government regulations had pervaded virtually all economic activity in the country. Fourth, there were continuing financial imbalances, notwithstanding the major efforts that had been made to correct them and the very sharp reduction in both the budgetary and external current account deficits. Both the budget and the balance of payments positions continued to be unsustainable, with substantial financing gaps, although those were lower than in previous years. Those imbalances had been exacerbated by the external debt burden that Niger had incurred in the late 1970s and early 1980s, when it had borrowed very heavily for investment purposes, particularly in infrastructural projects.

The medium-term adjustment strategy had to be viewed against that background, the staff representative continued. Together with the authorities, the staff had focused on three major objectives. The first objective was the promotion of economic growth. The rate of economic growth had to be viewed against the background of the significant physical constraints that the country faced. The measures that were being implemented aimed at doubling the rate of economic growth during the period of the program from an estimated 1.1 percent to 2.1 percent annually from 1987 through 1990 and achieving a rate of real economic growth of 2.9 percent from 1991 through 1995, rates that were fairly modest. However, the staff had undertaken, together with the World Bank, a detailed analysis to determine what the rate of economic growth would be without the structural adjustment measures. It was possible that the authorities' target of a real rate of economic growth of 3 percent might be attained provided that unusually good weather conditions prevailed and world market conditions improved significantly, particularly for uranium.

The second objective was to achieve a reduction in the rate of inflation from an average of 8 percent in the GDP deflator over the past few years to about 6 percent during the program period, the staff representative stated. That reduction implied that the authorities would have to pursue fairly restrictive credit and fiscal policies. However, since the economy was undergoing major structural changes, it was expected that there would be inflationary pressures arising from friction within the economy as the structural changes took place. The objective had been to try to contain to the greatest extent possible the rate of inflation as measured by the GDP deflator. Nonetheless, it should be pointed out that the consumer price index could turn out to be considerably lower than the rate of inflation indicated by the GDP deflator. Indeed, in 1985, the consumer price index had shown a negative rate of inflation, owing to the importance of the food component in that index.

The third key objective was to attain balance of payments viability by 1990, the staff representative continued. In addition to the adjustment measures envisaged, there were three key assumptions behind the balance of payments projections: uranium prices would increase by 3 percent annually; favorable weather conditions would reduce the demand for food imports; and petroleum prices would rise by an average of only 7 percent a year. The projection for uranium prices was critical to the attainment of balance of payments viability by 1990, given that uranium constituted about 80 percent of Niger's exports. The staff had presented a scenario that maintained constant prices for uranium over the period, and the readaptation of policies that will be needed to achieve viability by 1990 in such circumstances. The projection of a limited growth rate for exports was based mainly on the assumption of no growth in uranium exports in volume terms during the program period. The other major export item, livestock, was currently undergoing a period of reconstitution, following the period of drought. Hence, the effect of those two activities would be to limit the growth of exports.

The projections for external grants, directly related to grant-financed investment, the staff representative said, and the amounts shown through 1989, were those that had already been committed under the public investment program.

In the context of the medium-term policies, the objective had indeed been to attempt to generate conditions for fostering private sector economic activity and promoting economic growth, the staff representative went on. The policies that had been developed had taken into account the policy constraints facing the economy relating to public resource management, and had included measures to restructure government expenditures, mobilize revenues, and redirect government public sector investment toward the productive sectors. In that context, the narrowing of the budget deficit would allow the release of resources to the private sector. Among other elements of the medium-term policy were: the reform of the public enterprise sector; the liberalization of pricing and marketing policies; the pursuit of an active agricultural policy; and the pursuit of a tight financial policy aimed at both reducing the budget deficit--thereby eliminating the need for domestic bank financing of government activities--and rechanneling those resources to the private sector in Niger.

Responding to the observation that not all the policy measures covered the three-year period, the staff representative noted that the policy measures for 1986/87 had been set primarily as prior actions. A number of measures were being prepared for which studies would be undertaken during 1986/87 to form the basis for further action in future years.

The staff had placed considerable emphasis on the importance of a well-designed public investment program, the staff representative commented. In 1985/86, the authorities, in consultation with the World Bank, had formulated for the first time a three-year rolling public investment program that had been updated and covered the years 1987 through 1989. The Bank had reviewed the program and considered its sectoral composition and financing to be appropriate. The emphasis in the program was on directly productive sectors that would help expand the productive capacity of the economy. The program also emphasized the development of human resources and the rehabilitation of the existing infrastructure. In view of the external debt burden, the public investment program also stressed an increasing shift toward grant-financed investment. The proportion of external grants would rise from about 49 percent in 1985/86 to about 57 percent in 1989/90, and the proportion of external borrowing would drop from 44 percent in 1985/86 to 37 percent in 1989/90. Furthermore, the program envisaged a substantial increase in investment. The investment target for 1986/87 was projected to rise by 14 percent over 1985/86, which would imply an increase in public sector investment of about 10 percent, since the deflator for investment was considerably lower than the average deflator for GDP. The impact of the program on the private sector could be expected to be substantial because it provided for investment in the agricultural sector where most private sector economic activity was concentrated.

The adjustment program provided for the continuing implementation of the public enterprise project launched in late 1985 with the assistance of the World Bank, the staff representative continued. It was very difficult to quantify exactly the importance of each of the public enterprises under the reform program. The staff paper indicated five key enterprises, and in the most recent background paper, several tables had been provided that presented all the information the staff had been able to obtain on the public enterprise sector. The major problem with regard to the public enterprise sector had been the lack of comprehensive and complete data; hence, the focus had been on the five enterprises viewed as the largest.

In developing its structural adjustment program, the World Bank had also suffered from limited information about public enterprises, the staff representative remarked. However, the Bank had noted that the restructuring measures would be expected to have an immediate and positive impact on public finances. The first improvement would come from the rehabilitation of the ten selected public enterprises, which together accounted for about CFAF 35 billion in operating losses over 1980-83. Further financing should bring about a marked improvement in the profits statement, thus reducing the need for future borrowing and government transfers. The privatization or liquidation of public enterprises would further reduce the drain on budgetary resources. The enterprises that would be completely privatized or liquidated together accounted for operating losses of almost CFAF 2.5 billion in 1980-83, and received government transfers of CFAF 11 billion over the 1979-83 period. The study of cross-debts among public enterprises, which had been completed during the visit of the most recent mission, after estimated that cross-debts were about CFAF 16.1 million, but the staff was convinced that further work would be needed to verify those amounts. Therefore, the program for 1986/87 included as a performance criterion the repayment for 1986/87 of about CFAF 3.3 billion that appeared firm.

The program for 1986/87 continued the attempt to improve the overall institutional legal framework within which the public enterprises operated, the staff representative noted. The authorities had taken two major prior actions: first, they had redefined the legal status of employees of public enterprises, separating them from the civil service; second, they had implemented a model charter that defined the responsibilities of management and the supervisory role of Government. The model charter would provide the basis for each public enterprise to set up its own charter. Specific action programs had been set up for the Postal and Telecommunications Office, the Cereals Marketing Board--which was one of the most important public enterprises in Niger--and the National Development Bank. The Government had already privatized a number of enterprises.

The authorities had made substantial progress in pricing and marketing policies, the staff representative observed. They had abolished all import monopolies and quasi-monopolies, except for petroleum products. They had fully liberalized all the imports of millet and sorghum and the trade of those items between countries. They had abolished the export monopoly for cow-peas, and introduced a system of tenders and bids for the wholesale purchase and sale of cereals by the Cereals Marketing Board. Furthermore, they had reduced the number of goods subject to price ceilings at the beginning of the current fiscal year, from 27 to only 7; 200 imported goods were subject to specific resale profit margins, other imported goods were subject to 60 percent profit margins. The 200 imported goods subject to resale profit margins had since been reduced to 64 goods, including rice, sugar, educational books, insecticides, soap, pharmaceutical products--all items that the authorities viewed as essential. However, there was no data available that would indicate the percentage of those goods in the total imports of the country because the authorities did not collect such information. Nonetheless, the authorities had recognized that the process of liberalization would have to continue and that the 64 remaining products on the list would have to be further reduced over the three-year period. Developments would be reviewed at the time of the midyear term review of the program and subsequently in the two remaining years. The authorities had indicated there might be a few goods toward the end of the period that would have to remain under some form of control.

The authorities were preparing an extensive study of rural development strategy in collaboration with the World Bank, which was expected to be completed by 1988, the staff representative remarked. However, given the time frame for the preparation of the study, it had been agreed that in the meantime the Government would implement a number of measures that would be conducive to promoting agricultural production and reducing agricultural distortion. For example, the revised cereals marketing and pricing policy would promote private sector intermediation. In particular, the stabilizing role of the Cereals Marketing Board in terms of agricultural prices had been eliminated. The subsidies on agricultural imports would be reduced in a phased manner from the current 40-50 percent to a maximum of about 15 percent of the wholesale price by 1988. There would also be an increase of 40 percent in public sector investment in the rural sector in 1986/87. In addition, the authorities had taken steps to improve loan recovery in the agricultural sector and were working closely with the World Bank on a reform of the agricultural credit system.

The public finance situation in Niger remained difficult, the staff representative observed. The progress made so far was illustrated in the decline of the budgetary deficit on a commitment basis, excluding grant-financed investment and grants, from about 4.9 percent of GDP in 1984/85 to 3.9 percent in 1985/86; the deficit was projected to further decline to 3.5 percent of GDP in 1986/87. The program for 1986/87 did not provide for credit to the Government from the banking system. Expenditure, which was projected to rise by about 8.2 percent, reflected largely the sharp increase of 12.7 percent in capital expenditures and an increase of about 12.3 percent in interest payments on domestic and external debt. Other expenditures would rise by only 3.3 percent, implying a cut in real terms.

The envisaged cut in scholarships for study abroad reflected a streamlining process in order to increase efficiency, the staff representative said. Students who did not meet the minimum academic standards at the institutions where they were studying would be recalled. Moreover, the granting of scholarships would become more selective. Nonetheless, the benefits expected from the reduction of not only scholarships, but also housing allocations and other transfer subsidies, would be directed to providing more allocations for operations and maintenance, including facilities for domestic education, which would contribute to improving the human capital base.

Revenues were expected to increase by 8.2 percent or above the rate of expenditure increase, the staff representative remarked. Over the past three years, the Government had already introduced all the tax measures recommended by the Fund's technical assistance mission. However, the full effect of those measures would be felt only over the medium term. There had been concern that those measures might not have resulted in a significant improvement in the elasticity of the tax system over the short period during which they had been implemented. Consequently, the authorities had requested financial assistance from the Fund to prepare a study that would evaluate the reform of the tax system and tax administration that had been implemented and to identify additional measures that would contribute to further broadening the tax base and improving the elasticity of the tax system. Tax revenue was expected to increase by 6 percent in 1986/87 in line with its major dependence on customs duties, which would increase by about 5.9 percent from dutiable imports, taxable exports, and mining royalties. In order to increase revenues, the authorities were channeling a substantial amount of resources resulting from the profits in the oil sector into the budget.

The authorities had made progress on the study of the civil service that would attempt to determine employment needs and recruitment policies, the staff representative said. It was expected that the study would be completed in time for the midterm review so that action could be taken at that time.

The program for 1986/87 provided for all credit to be extended exclusively to the private sector with no growth of credit to the government sector, the staff representative commented. The increase in credit to the private sector in 1987 would rise as a proportion of beginning money stock from 4 percent in 1986 to 8.3 percent in 1987.

The staff did not have information on the observance of performance criteria for end-September 1986 with respect to credit, because normally that information was available only with a two-month lag, the staff representative noted. On the basis of available indicators, the expectation was that the credit ceilings for end-September would be met.

A uniform interest rate policy was set for all members of the West African Monetary Union by the Central Bank of West African States (BCEAO), the staff representative observed. That policy took into account developments in international markets and attempted to align interest rates with those in international markets. The BCEAO had instituted an across-the-board reduction in interest rates of 1 percent on September 22, 1986. However, the representative overnight money market deposit rate, which had been reduced to 7.8 percent at end-September 1986, remained positive in real terms. It should be noted that the rates set by the BCEAO for deposits of commercial banks represented only minimum rates; banks were free to set their rates in accordance with market conditions.

The external debt service position of Niger was difficult, the staff representative pointed out. The external debt service ratio before debt rescheduling was projected to rise to 51 percent in 1987, but to decline gradually to about 38 percent by 1990. For that reason, the Government had previously sought debt relief from the Paris and London Clubs and other creditors. However, the lower financing gaps being projected, including for 1986, would mean that the need for debt rescheduling would be substantially reduced. A meeting of the Paris Club was scheduled for November 20, 1986 to consider Niger's request for debt rescheduling. The creditors that had not granted bilateral debt rescheduling to Niger were mainly certain Arab organizations whose statutes did not allow them to grant rescheduling. That matter had been repeatedly discussed at the Paris Club, and the authorities were exerting their best efforts to obtain some form of financial assistance that would effectively result in comparable treatment for debt to the Arab institutions. The Government was also taking certain steps to improve the management of its external debt, one of the most important of which had been taken on October 1, 1986, requiring the Minister of Finance to authorize all drawings on external loans. The computerization of the public debt data was another equally important step that was expected to be completed by the end of 1987.

The staff report for the 1986 Article IV consultation with Niger (EBS/86/109, 5/16/86) had included a description of movements in the effective exchange rate, the staff representative remarked. There had not been any significant change since that time. The real effective exchange rate had fallen on average by about 13 percent in 1983, with a further depreciation of about 1 percent in 1984 and about 4 percent in 1985. Based on the latest information, the real effective rate had depreciated further over the past 12 months. Since Niger was a member of the West African Monetary Union and shared a common currency with the six other members of the Union, the exchange rate policy had to be seen in the context of the Union as a whole. The staff had continued to review the situation and two comprehensive studies on exchange rate policy had been prepared in recent years. The authorities had emphasized that existing arrangements under the West African Monetary Union had served the member countries well, the overall advantages outweighing the loss of the exchange rate as an independent policy instrument. On average, overall economic performance had been as good if not better than that of African countries with independent exchange rates; the economies of the member countries had remained free of restrictions on international transactions; they had maintained a coordinated and well-balanced monetary policy; and the convertibility of the currency had helped to foster confidence in their economies. The major cause of Niger's current imbalances was the public sector deficit. Therefore, Fund programs had placed particular emphasis on fiscal adjustment, which meant that existing policy instruments had been used more intensively. In certain cases, fiscal proxies for exchange rate action had been used. Thus, the existing monetary arrangements could not be considered to have been overly restrictive for the choice of appropriate adjustment policies.

The issue of tax changes to further enhance production incentives could be taken up in the context of the technical assistance that the Fund would be providing to the authorities in the coming months, the staff representative from the African Department concluded.

The staff representative from the Exchange and Trade Relations Department said that the suggestions made by Directors would be considered in the forthcoming staff paper on the structural adjustment facility.

The staff did not have any set formula to determine the optimal number of benchmarks, the staff representative continued. The objective was to specify as benchmarks certain key financial and structural policies to achieve the objectives of the program. The number and nature of benchmarks reflected the type of policy measures being undertaken, which obviously would vary from case to case; measures of import liberalization, exchange rate action, tax reform, and supply-side measures might not be relevant to all situations.

The quantified performance criteria under the stand-by arrangement and the benchmarks under the structural adjustment arrangement were integrated and mutually consistent in that the program was being implemented under both arrangements simultaneously, the staff representative concluded. However, the two arrangements should be considered as distinct from one another, because their functions differed.

Mr. Vasudevan observed that in his opinion the benchmarks, which covered all the policies specified in the letter of intent, were far too numerous. Although he understood that structural adjustment arrangements were to be flexible, with few benchmarks, most arrangements approved so far had contained too many benchmarks that appeared to have no operational significance.

The Chairman noted that concern had been expressed about the extended period over which the structural reforms were to be implemented, after the initial steps were taken, suggesting that there might not be enough precision and rapidity in the formulation and implementation of structural policy actions. Another concern was that the structural adjustment arrangement should not be too restrictive in terms of benchmarks for the major indicators. Thus, it was necessary to establish a compromise between vagueness and extended implementation, which was obviously a complicated problem.

Mr. Vasudevan remarked that the reviews that would be undertaken under the structural adjustment arrangement would themselves identify problems and establish future policy actions. Thus, he did not feel it necessary to have such benchmarks.

In response to a remark by the Chairman, Mr. Vasudevan agreed that, in a sense, the benchmarks were a way of monitoring ongoing efforts at the time of reviews by staff missions.

The Deputy Managing Director noted that if the benchmarks were not explicitly specified in the context of the annual program, they might have to be more explicitly specified in the policy framework papers that were the basis for monitoring the evolution of the program over the three-year period. The annual program allowed for greater specification of policies than the policy framework paper. In discussions with the World Bank on structural adjustment arrangements, there seemed to be a feeling that even the policy framework papers did not lay out the policy path with sufficient precision, which would be the direction that the papers would have to take if there was to be less emphasis on the broad specification of benchmarks in the context of the annual programs.

The staff representative from the Exchange and Trade Relations Department observed that the distinction between the stand-by arrangement and the structural adjustment arrangement was not merely technical. Since the structural adjustment arrangement for Niger had a life of three years compared with the 12-month life of the stand-by arrangement period, the former had to stand on its own on the demand as well as the structural side. Therefore, in Niger's case it had been convenient to have some of the performance criteria as financial benchmarks. In other situations the benchmarks might be treated differently; there was no rigid rule but the purpose was to focus on certain crucial indicators to permit the monitoring of progress under the program.

The staff representative from the World Bank observed that Niger had one of the lowest income levels in the world and was one of the world's least developed countries. Furthermore, long-term economic trends had been very discouraging. As agricultural production had grown in the past by extending the area under cultivation with no change in the level of technology, the gradual reduction in the availability of new cultivable land had resulted in fallow periods being reduced, thereby causing agricultural productivity to decline. Thus, with respect to long-term agricultural growth, there was a declining trend in per capita production and consumption. Although a number of corrective measures had been undertaken, none of them had been very successful thus far. There had been an effort in the early 1980s to apply what had been seen as promising technical packages to rain-fed agriculture to increase the production of sorghum and millet. However, the level of rainfall had been too low and too unpredictable to make those technical packages viable in Niger. Irrigation had proven to be very expensive on a per capita basis and did not appear to be a solution to the productivity problem, given the limited financial resources available both domestically and externally.

The Bank's agricultural study of Niger had been initiated against that background of declining production per capita in agriculture, the staff representative continued. The Bank had made a grant of $500,000 under its special project preparation facility to finance that study;

additional resources had been provided by the Caisse Centrale. The major uncertainty appeared to be related not to how quickly the study could be completed, but to whether it could find a solution to the very difficult long-term growth problem. The study would consider such aspects as: agricultural research to investigate new technologies; pilot projects for small rural operations; the role of irrigation; and the adaptation of various technical packages in rain-fed agriculture. The relation of population growth to agricultural production would be highlighted because with the expansion of population against the very limited agricultural resources, in terms of both quantity and quality, per capita production levels would be difficult to maintain over the long term. The need for a determined family planning effort was becoming essential as time went on.

World Bank lending to Niger had expanded rapidly over the past 12 months with the intensification of the Government's structural adjustment effort, the staff representative remarked. In the Bank's 1986 fiscal year, it had approved credits totaling about $130 million from IDA, the Special Facility for Sub-Saharan Africa, and the special joint financing facility. That total was more than six times the average level of financing in the preceding five years when IDA credits had averaged $20 million annually. Although the very high level in 1986 represented a bunching of some operations that had been developed over the preceding year, the continuation of a substantial level of Bank lending was anticipated. Discussions were being conducted with the authorities about annual levels of assistance in the range of $60-70 million. However, that level would be dependent upon the level of replenishment of IDA-8.

The first structural adjustment loan by the Bank had concentrated on three areas that appeared to be clearly in need of attention and where the measures to be taken were reasonably defined, the staff representative said: the utilization and mobilization of public resources; the restructuring of the public enterprise sector; and agricultural policy. Those areas appeared to continue to require attention and would be addressed in future structural adjustment operations, which would also be supported by sectoral operations. For example, the Bank was currently developing a public enterprise restructuring project that would build upon the efforts already under way under the structural adjustment loan and the Fund's structural adjustment arrangements. Future structural adjustment loans might also cover private sector incentives and energy, which had been in need of support when the first structural adjustment loan had been implemented at that time, the required measures had not yet been clearly defined, but further studies had been undertaken that could lead to action in those areas at a future date.

Mr. Mawakani thanked the Executive Directors for their constructive observations on Niger's adjustment efforts and their support of the requests for the structural and stand-by arrangements.

The Executive Board then took the following decisions:

Niger - Stand-By Arrangement

1. The Government of Niger has requested a stand-by arrangement in an amount equivalent to SDR 10.11 million for a period of 12 months from December 5, 1986 through December 4, 1987.

2. The Fund approves the stand-by arrangement set forth in EBS/86/237, Supplement 1.

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

Decision No. 8451-(86/183), adopted
November 17, 1986

Niger - Structural Adjustment Arrangement

1. The Government of Niger 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/86/237, Supplement 2.

Decision No. 8452-(86/183), adopted
November 17, 1986

4. PEOPLE'S REPUBLIC OF MOZAMBIQUE - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Mozambique (SM/86/259, 10/21/86). They also had before them a background paper on recent economic developments in Mozambique (SM/86/268, 11/4/86).

The staff representative from the Exchange and Trade Relations Department said that, subsequent to the discussions with the authorities on the Article IV consultation with Mozambique held in July 1986, the staff had continued the dialogue and a mission had returned from the country about two weeks ago. Despite the tragic death of the President during its visit, the mission had received full cooperation from the authorities. In particular, the mission had further discussed the implications of the planned exchange rate policy and pricing policies that would be the centerpiece of the program. Although considerable information had been collected on public sector enterprises, further work remained to be undertaken, particularly in the area of fiscal and credit policies. World Bank staff were currently in Mozambique and were developing with the authorities the structural elements of the medium-term program and continuing their specific sectoral work in agriculture, industry, and transportation.

Mr. Abdallah made the following statement:

The embattled young nation of Mozambique has recently suffered the tragic loss of its political leader who was killed in a plane crash in South Africa under mysterious circumstances. The Mozambican people have borne the loss with fortitude and have effected a peaceful transfer of power to a successor who was the right-hand man of the deceased leader--a man who was actually the country's first Prime Minister and Acting Head of State. Thus a known, experienced, and pragmatic person is now at the helm.

The staff visit on which the papers currently before the Executive Board is based occurred before the tragic event. A technical mission has since been to Mozambique and has found no change in personnel who are holding key economic positions nor any weakening in their commitment to continue with strong and comprehensive adjustment policies. All this augurs well for the future.

The staff report has analyzed recent economic developments in the country in a fairly lucid manner and has regrettably concluded that the problems have intensified. The mounting pressure on the country's balance of payments position, the rise in inflation, and the increasing size of the budget deficit all speak for themselves. In addition, real output is expected to stagnate in 1986 after registering substantial decline in each of the past four years. These are manifestations of the difficult circumstances that Mozambique has faced since independence, including prolonged and severe droughts and an insurgency that has undermined security and forced the Government to devote a great deal of its time and resources to defense in order to safeguard national sovereignty. The authorities' ability to manage the economy has also been hampered by the absence of adequately trained manpower, an unfortunate legacy of the colonial era.

Nevertheless, Mozambique is a nation with economic potential, being well endowed with natural resources and having the benefit of a relatively diversified export base. The authorities therefore are striving to develop appropriate policies and to seek assistance from friendly countries and multilateral agencies to unleash the productive capacity of the country. Needless to say, this is being done against the background of continuing insurgency, which is increasingly concentrating its fire on civilians and socioeconomic targets.

The Fourth Congress of FRELIMO--the ruling party--held in April 1983 marked the beginning of the authorities' effort to reassess their economic policies and to develop new approaches to economic management. At the time, it was considered appropriate to place emphasis on the development of smallholder farms in order to increase agricultural production and to promote investment in light industry. Meanwhile, private investment was given greater encouragement and, subsequently, a foreign investment code was enacted in 1984. The authorities also decided to expand economic relations with the international community, which resulted in Mozambique becoming a member of the Fund in September 1984.

Faced with continuing deterioration if the economy, the authorities have embarked upon the task of formulating a comprehensive adjustment program to be implemented from the beginning of next year. As the staff report indicates, a major restructuring exercise is being contemplated; accordingly, the program is being framed within a medium-term context. The authorities have in mind the need to expand output, especially exports, and to rehabilitate and maintain infrastructure. They have no illusions about this being a monumental task, and are aware that although the seriousness of the economic situation demands prompt attention, the present sociopolitical environment dictates that the pace of adjustment will have to be determined on a practical and feasible basis. The important point, however, is that work on finalizing the program should move as quickly as possible to keep pace with the momentum of the authorities to get started with the adjustment process and to face any obstacle that may arise. Behind this determination is their firm intention to seek support from the Fund under the structural adjustment facility.

The difficulty of containing the growth of expenditure in the face of declining revenues has weakened the financial position of the Government. Increasing resources have had to be used for defense and the rehabilitation of infrastructure destroyed by the insurgents, in addition to concentrating on such investments as can be undertaken on agriculture, industry, and energy in order to arrest further deterioration of the economy. Recently, sizable outlays have been required for interest payments on past foreign borrowings, which tend to limit the extent to which expenditures can be reduced in the short term; however, the authorities fully recognize that the current situation is untenable, and that corrective action must be taken. In this connection, steps are being taken to contain expenditure and to increase revenue. With regard to the latter, discretionary tax measures are being considered, along with measures to improve tax administration and to reduce tax evasion.

The fiscal situation is expected to benefit from improved financial control in public enterprises. In order to improve profitability in this sector, the intention is to liberalize the pricing structure together with the granting of greater autonomy to these enterprises. Management now has greater flexibility in hiring and laying off workers, and in developing incentive schemes to increase productivity.

Curbing the unlimited access of public enterprises to credit from the banking system will be a significant step toward controlling the expansion of credit and reducing the overhang of excess liquidity in the economy. Having assumed responsibility for financing projects formerly included in the investment budget, the Bank of Mozambique has begun to exercise stricter scrutiny of credit requests, complementing this with improved monitoring and disbursement procedures. It is expected that the rationalization of credit procedures will be enhanced by a flexible interest rate policy and by improvement in the quality of monetary data.

Mozambique's external payments position has come under severe pressure in recent years, and the accumulation of arrears has become a major means of financing the deficit. Exports declined substantially between 1980 and 1985, a situation attributable in part to the misalignment of the exchange rate. A discernible impact of the scarcity of foreign exchange is the extremely low level of capacity utilization in the industrial sector, which is highly dependent on imported inputs and spare parts. This prompted the introduction of a foreign exchange retention scheme for export enterprises to help keep them in operation. Considering this to be only a short-term solution to the exchange crisis, the authorities are aware of the need to expand exports by providing adequate incentives to producers. In this connection, it is envisaged that an active exchange rate policy will play an important role, in conjunction with a pricing system that provides adequate remuneration to producers.

The acceleration of the debt service burden poses a major constraint to the recovery of the Mozambican economy. The scenario in the staff report suggesting that the debt service ratio could reach 150 percent of export earnings in 1988 vividly highlights the extent to which Mozambique's adjustment program will depend on the availability of concessional financing. Mozambique's situation is clearly a case where domestic policy reorientation must be supported by increased concessional aid. In this context, it is hoped that financing under the structural adjustment facility will catalyze additional resources from other multilateral agencies and donor countries.

Mr. Ayales made the following statement:

I would like to express my agreement with the staff report that, given the restrictions imposed by very limited reliable data, provides a fairly good description of the country's financial, economic, and political situation. I would also like to thank Mr. Abdallah for his opening statement. I was very pleased to hear from the staff that the technical mission that has just returned from Mozambique was able to make substantial progress in analyzing the effects of pricing and exchange rate policies, and that the authorities are still very committed to the economic reforms being discussed.

I would like to say that we, too, are very concerned about the continuing deterioration of the economic and financial situation of Mozambique, and the very difficult and disruptive security problem in some parts of the country. In addition to this, the Mozambicans recently suffered the tragic loss of their head of state.

Nevertheless, we know that they have accomplished a very peaceful and smooth transition, and that over the past year the authorities have been working out the elements of a comprehensive package of measures for economic and financial reconstruction in a medium-term framework.

Although there have been some improvements in the quality and availability of economic data--improvements that have been supported by the Fund through the provision of technical assistance in different areas--the data base remains weak and imposes serious limitations on the analysis of economic and social developments. Therefore, I believe that the joint effort to reverse this situation should continue in the future.

I would like to stress the importance of more realistic and flexible exchange rate and pricing policies, supported by tight demand management policies, which can contribute to the elimination, or at least reduction, of the extensive parallel markets of goods and foreign exchange that have grown very rapidly, much to the detriment of public finances because these transactions are not taxed. A comprehensive liberalization of consumer and producer prices, together with a flexible exchange rate policy, will be necessary to substantially reduce the size of these markets.

Very strong actions are also needed in the fiscal sector, in which easy access to credit from the Bank of Mozambique--mainly to cover losses incurred by the public enterprises--has contributed to the very large monetary overhang in the economy. Substantial improvements in the finances of public enterprises' finances and measures to correct the budgetary imbalances are indispensable. We are glad to know that the authorities, in close collaboration with the World Bank, are working toward this end, especially with regard to the public enterprise sector.

Although the country's external financing prospects are very bleak and uncertain, early adjustment measures could bring about a significant change over the medium term. This would require the full support of the World Bank both for the financing of a structural adjustment program and additional rehabilitation loans and project assistance, the support of the Paris Club to reschedule the country's outstanding foreign debt based only on a program under the structural adjustment facility, and substantial concessionary assistance from abroad.

Given the seriousness of Mozambique's economic and financial difficulties, we find the wide-ranging and far-reaching set of measures being implemented a very important step toward financial and economic reconstruction. However, we note that in an extremely difficult security situation, these measures cannot be expected to have as positive effect on production and exports as they would otherwise have had. Nevetheless, we believe that these corrective measures are essential and that the authorities should be encouraged to proceed along the path that they have chosen.

Once the authorities undertake the program--which may be very soon--donors and friends of Mozambique may wish to consider that in addition to project-linked resources, relatively small but quick-disbursing amounts that can be used to provide much needed imports and incentive goods can make crucial contributions at the outset of the program.

The staff's projections make it very clear that, even under an optimistic scenario, there is a large financing gap in the balance of payments, despite the significant amount of aid Mozambique receives. This indicates that not only donors, but also creditors, will have to make an extraordinary effort for the program to become a reality.

We recognize the difficult situation the authorities face and the hard choices they will have to make, and are already making. But we believe that they are fully committed to the course they have indicated and we would like to extend them our best wishes and encouragement.

Mr. Wijnholds made the following statement:

As clearly demonstrated in the staff report, the economic situation in Mozambique is very grave. The huge decline of domestic production in recent years, the enormous contraction of foreign trade, and the many distortions in the economy provide a very bleak picture indeed. It is obvious that external factors have played an important role in Mozambique's economic decline, but there is little point in disregarding the important internal component of the deterioration. It is encouraging that the authorities recognize the need for a new departure in economic policies and are continuing discussions with the Fund with the intention of reaching an agreement on a structural adjustment arrangement.

Mozambique has operated a controlled economy while lacking some of the essential ingredients that make it possible to implement central planning with any degree of success, such as the absence of a statistical base or an adequate institutional framework. Also, the lack of trained manpower has clearly been a problem. Under these circumstances, a less centralized approach would stand a better chance of success. But whatever approach is followed, there is an urgent need for better information on the economy. Technical assistance by the Fund and other international organizations can be a high-yielding undertaking in Mozambique.

The need for a comprehensive package of adjustment policies is evident. Such a package would pave the way for Fund and World Bank support, which could give the appropriate signal for donor countries to join together to provide the highly concessional resources that are so badly needed. An important complication is the continuing security problem, which may raise doubts about the effectiveness of measures aimed at the rehabilitation of the economy. Nevertheless, I think that the Fund could play a useful role by providing a structural adjustment arrangement to Mozambique, if agreement can be reached on a package of demand management and structural measures. However, I doubt whether the use of regular Fund resources would be appropriate under the present circumstances. Indeed, I do not believe that the authorities are asking for such resources. I would add that not only would such funds be relatively expensive for the country, but it is also doubtful whether at the moment Mozambique has the capacity to effectively implement and monitor the precise performance criteria that are generally set under regular Fund programs.

The measures that the authorities are now planning to take point in the right direction, but much will depend on implementation. A combination of cautious demand management policies and far-reaching structural policies aimed at drastically improving the supply side of the economy is clearly called for. Agricultural production, including export-oriented production, should be drastically expanded, which will necessitate adjustment of the exchange rate and of producer prices. The budget deficit needs to be controlled much more closely than before, as does domestic credit expansion. *Given the huge imbalances that exist in the economy at* present, a quite drastic approach seems to be called for. Therefore, I fully agree with the staff that a gradual approach is likely to lead to failure. I sincerely hope that the authorities will find it possible to act decisively in dealing with their deep-seated problems and that the international community will react in an appropriately generous fashion.

Mr. Foot made the following statement:

It is a matter of regret that Mozambique's economic and financial position has deteriorated since the discussion by the Executive Board of the 1985 Article IV consultation. We join in welcoming the medium-term policy framework as a basis for negotiations with the Fund. We would encourage the authorities to develop more concretely the policy elements of that medium-term framework and take the necessary prior actions.

The key issues, as the staff report notes, will be the timing and the extent of the adjustment measures. It seems that urgent action up front is particularly needed in four areas. First, in exchange rate policy, where it is clearly important to close the gap between the parallel and official exchange rates as quickly as possible, thereby bringing the parallel sector of the economy back into the official sector. Second, revenues must be increased and the revenue base extended. I note from the staff report that tax revenue has fallen from 15 percent to 7 percent of GDP over the past 6 years, which is a measure not only of the problems the authorities face, but of the steps they must now take. Third, there must be a rapid move to liberalize pricing policy. It is disappointing that the authorities intend to maintain subsidies on certain goods. I would urge them to keep that list as short as possible. Fourth, there needs to be a rapid move to a realistic monetary policy that incorporates positive real interest rates.

Overall, the authorities must show that external viability is a reasonable long-term prospect if the Fund is to be of any help to Mozambique in its current very difficult circumstances.

I think it is impossible to offer firm advice on the timing or procedures for a structural adjustment arrangement at this stage. Clearly, that is a matter for the discretion of the Chairman. However, I would recall briefly the comments by the Executive Directors to which the Chairman alluded to in his summing up of the discussion on the structural adjustment facility in March 1986 (EBM/86/55, 3/26/86): "Where a country is less advanced in the formulation of medium-term structural policies, a separate set of talks would probably have to be conducted with the country by the two staffs in order to arrive at a common understanding that would lead to a framework paper for review by the two Boards. Later, the Fund would take up the specific program according to its own schedule and procedures, as hopefully would the World Bank." I am not saying that is the procedure that would need to be followed in this case. It would depend in part on the comprehensiveness of prior actions and the extent to which the Fund staff believed it could come to the Board in one step rather than two. But it is a possibility we would like to leave open.

Mr. Mawakani made the following statement:

Although the staff report shows that the economy of Mozambique continues to face serious difficulties, it also indicates that the authorities are very concerned about those problems and are considering corrective measures. The task that faces the authorities is formidable indeed, and it is encouraging to learn from Mr. Abdallah's informative opening statement about the authorities' resolve to face this challenge. In addition to security problems--which are absorbing a large proportion of scarce resources--the country has practically no infrastructure and very little qualified manpower. The authorities are correct in taking a comprehensive and coordinated approach to try to resolve the many problems facing the country. I was thus encouraged to read that the Government is holding discussions with the Fund and the World Bank to try to prepare a medium-term program aimed at adjusting the economy. The main elements of this program, as outlined on pages 14 and 15 of the staff report, seem to be in the right direction and appear to address the main problems. However, the authorities need to speed up the implementation of the adjustment measures.

I note from the staff report that parallel markets for commodities and foreign exchange have emerged, which indicates that the present price system is not working well. The authorities would be well advised to deal with these markets first, thus laying the basis for a more efficient economy.

With regard to the fiscal sector, defense spending at about 45 percent of total expenditure certainly puts a heavy burden on the budget, and until the security problem is resolved this item will continue to adversely affect the allocation of resources. The authorities are aware that budgetary performance can be improved, as shown by their intention to develop other tax and expenditure measures. The staff also made some suggestions to improve government revenue and outlays, to which I would urge that the authorities give full consideration.

It appears that the balance of payments position will continue to be rather difficult in the medium term, with the servicing of the external debt continuing to take up a large part of export earnings. The authorities will need additional capital inflows to restructure the economy and achieve economic growth. Further debt relief in the form of debt renegotiation will clearly be inadequate. As mentioned on page 17 of the staff report, the burden of the existing debt is such that "an exceptionally strong adjustment effort, coupled with considerable external financing, will be required to re-establish the basis for economic recovery and orderly relations with creditors." I fully agree with this statement and I hope that the international community will provide Mozambique with the assistance that it needs to achieve these goals.

Mr. Rousset made the following statement:

This Article IV consultation with Mozambique is the second since Mozambique became a member of the Fund in 1984. Since that time, the Fund has provided assistance to the authorities in the policy-making necessary to reverse the decline of Mozambique's economy. Unfortunately, since our previous discussion on the 1985 Article IV consultation (EBM/85/103, 7/3/85), the situation has deteriorated substantially and the economic and financial picture shown by the staff report is a very difficult one.

Major declines have taken place in agriculture, industry, and transportation. Real wages and the living standards of the majority of the population have been reduced. The financial position of the Government is expected to show severe deterioration in 1986. The portfolio of the banking system consists mostly of nonperforming loans, and money supply has nearly tripled during the past four years.

On the external side, exports have declined to $77 million, compared with $280 million in the early 1980s. External arrears have accumulated and, as a result, the import program has been constrained to the extent that shortages of raw materials, spare parts, and consumer goods have contributed to reducing the productive capacity of the country and the incentive for rural producers to harvest and market their production. Thus, the economy is caught in a classic downward spiral.

Clearly, the situation has become unsustainable. Even if a number of the causes of Mozambique's present plight are beyond the control of the authorities, it remains true that the problems have been compounded by inadequate domestic policies.

Therefore, I welcome the authorities' economic rehabilitation program for 1987-89 and their willingness to continue to discuss its elements with the Fund. Obviously, these measures were discussed extensively. There is no disagreement on the objectives and on the type of policies necessary, but there are still differences of opinion about the pace of reforms and their scope. Many policies, including the liberalization of prices, imports and trade, credit, and the introduction of the notion of profitability in public enterprises represent a considerable change in the authorities' way of thinking and managing the economy. The reservations of the authorities, who feel that the lack of control could lead to unpredictable slippages, are understandable.

Nevertheless, I share the staff's views on the need to implement a consistent program. I also feel that an approach that is either too slow or leaves aside some important areas would prove ineffective in making the necessary adjustments. The cornerstone of the reform process must be a realistic and flexible exchange rate, which should be set with a view to reaching an appropriate rate as soon as possible. To be efficient, this measure must be accompanied by such essential policies as the introduction of flexibility in the system of prices and the progressive liberalization of restrictions on trade and payments. I also share the staff's views regarding the emphasis that needs to be placed on the control over credit expansion, the reform of public enterprises' finances, and the reduction of the overall budget deficit.

The medium-term balance of payments scenarios given in Table 5 of the staff report that compare the financing gaps for two different levels of imports are interesting. It would be useful if staff provided some indication of the impact on GDP growth of these two different levels of imports.

Given the considerable distortions plaguing Mozambique's economy, the authorities have an immense task before them. I encourage them to develop the policy elements of their medium-term program more concretely. Meanwhile, and as a first step, I encourage the authorities to implement the recommendations of the staff report.

I share the staff's view that a very gradual approach to adjustment would carry with it a serious risk of failure. The reform process will be a difficult task and a formidable challenge, but I am confident that the authorities will continue to find the assistance that they need from the Fund and the World Bank.

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

## DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/182 (11/14/86) and EBM/86/183 (11/17/86).

### 4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/86/282 (11/13/86) is approved.

APPROVED: July 1, 1987

JOSEPH W. LANG, JR.
Acting Secretary