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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/184

3:00 p.m., November 17, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
Dai Q.	
	E. L. Walker, Temporary
	P. Péterfalvy, Temporary
	C. A. Salinas, Temporary
	A. H. Mustafa, Temporary
	T. Morita, Temporary
	K.-H. Kleine, Temporary
	A. Iljas, Temporary
	J. Hospedales, Temporary
	J. R. N. Almeida, Temporary
	M. Foot
	S. Simonsen, Temporary
	D. McCormack
Mawakani Samba	C. V. Santos
	L. P. Ebrill, Temporary
	E. Ayales, Temporary
	S. de Forges
	V. Rousset, Temporary
	J. de Beaufort Wijnholds
	G. K. Hodges, Temporary
	R. Msadek, Temporary
	A. Vasudevan, Temporary
	F. Di Mauro, Temporary

L. Van Houtven, Secretary
A. Akanda, Assistant

Also Present

IBRD: F. Agueh, Eastern and Southern Africa Regional Office. African Department: G. E. Gondwe, Deputy Director; Buu Hoan, M. E. Edo, S. N. Kimaro, M. C. Niebling, R. T. Stillson. 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, J. K. Oh. Research Department: A. Mullor-Sebastian. Treasurer's Department: J. A. Gons. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; J.-P. Amselle, M. A. Da Costa, H. E. Khor, S. J. Stephens, K. Thugge, G. Yadav. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, G. D. Hodgson, A. Ouanes. Assistants to Executive Directors: W. N. Engert, G. Ercel, J. M. Jones, S. King, G. Schurr, G. Seyler.

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

The Executive Directors continued from the previous meeting (EBM/86/183, 11/17/86) their consideration of 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).

Mrs. Walker made the following statement:

Since the 1985 Article IV consultation (EBM/85/103, 7/3/85), the Mozambican authorities have been discussing a comprehensive adjustment program and have agreed on some important measures aimed at addressing the serious financial imbalances in the economy. We welcome the authorities decision to embark upon a very difficult medium-term adjustment and recovery program, and we encourage them to press ahead with this work, most immediately in the development of the policy framework to be supported by Fund and World Bank programs.

However, even under the most optimistic economic outlook presented by the staff--one that includes substantial debt relief, donor support, and heavy external borrowing--balance of payments viability is not likely to be achieved in the medium term under currently planned policies. In our view, this signals the need for the authorities to develop a bold, comprehensive, and credible package of adjustment measures to achieve the required economic recovery and catalyze the desired financial support and debt relief from the international community. Since such a package may take time to complete, it may be appropriate to bring a policy framework paper to the Boards of both the Fund and the Bank before supporting programs have been finalized. In the meantime, some adjustment measures should be implemented in order to get the adjustment process under way and to signal to donors and creditors the authorities' strong commitment to this very difficult process of adjustment and recovery.

In our view, the World Bank's lead role in the adjustment process is very important, because Mozambique's situation clearly lends itself most to Bank support. Therefore, it is important that the Bank takes an active role at the outset in the development of the medium-term framework and in providing policy advice and financing under specific structural programs. The deeply ingrained structural problems, particularly public sector investment practices and public sector enterprise issues, must be addressed at an early stage within the context of the policy framework, in which the Bank's role is essential. Although the Fund should play a helpful role in this process, in our view the Bank should take the leading role. Depending on the timing under consideration, this need not imply a delay on the part of the Fund, but perhaps an acceleration on the part of the Bank, assuming that the authorities are prepared to move quickly with both policy actions and commitments.

In policy areas, we welcome the agreement to institute a more realistic exchange rate policy. We would appreciate staff comment on the authorities' intention to make discrete quarterly devaluations. We believe that with parallel market rates substantially exceeding the official rate, the objective of closing the gap between the two exchange rates should be accomplished as quickly as feasible. A more realistic exchange rate level should also provide scope for the relaxation of exchange and trade restrictions, and we hope a plan for the elimination of the restrictions could be included in the three-year program. In the meantime, we believe some movement in the direction of liberalizing trade restrictions should be initiated together with the exchange rate changes. Increases in interest rates could serve as an immediate complement to the exchange rate actions.

We welcome the authorities' intention to implement a more liberal pricing policy. As shown in Table 3 on page 11 of the background paper, parallel market producer prices at levels much higher than official producer prices for export products clearly have hindered production of export products. Increases in producer prices should help reverse this trend, as demonstrated by the substantial increase in marketed production of vegetables that occurred in 1985 after prices were freed. While it is essential that the authorities raise export producer prices to at least the extent of the initial exchange rate depreciation in light of the current low level of exports--one that is not projected to reach 1981 levels for several years--we think that further adjustments would be needed. We would appreciate staff comment on this issue.

We welcome the authorities' plan to remove products from the fixed-price list and urge them to be as liberal as possible in allowing producers to change prices. However, we question the feasibility or desirability, in the face of serious budgetary constraints, for the Government to subsidize the prices of five commodities through the budget.

While some important measures have been taken or agreed to in the pricing and exchange rate areas, other areas need further attention, particularly fiscal accounts, in which the underlying position may be even worse than appears on the surface. The authorities seem to be concentrating their efforts on improving the fiscal situation through an increase in revenues. While expenditure reduction may be difficult due to high levels of defense expenditure, there must be some scope for further savings, and we urge the authorities to look in this direction as well. Furthermore, it will be important that expenditure be allocated efficiently and rationally. In this regard, we believe that the results of the sectoral investment study by the World Bank should be incorporated into the policy framework paper to provide a basis for confidence that government expenditures are well directed. We also believe that it is important to put an effective mechanism in place to ensure that government credit targets, which could be included in a structural adjustment arrangement, can be observed.

Reform of the public sector enterprises is clearly needed. We welcome the intention of the Bank of Mozambique to finance only viable investment outlays of these enterprises in the future and to cover their operating losses by the budget. However, without a complete reform of the sector, it will not be possible to make lasting improvements in the financial positions of the public sector enterprises. Therefore, it is essential that the results of the World Bank study on public sector enterprises be incorporated into the policy framework paper and programs that will be negotiated under the umbrella of the policy framework.

Clearly, work remains to be done on outlining realistic medium-term fiscal, balance of payments, and structural adjustment objectives, including the level and composition of imports necessary to achieve economic recovery. However, we welcome the progress made thus far in discussions with the Fund and the Bank and in the actual measures that have been agreed upon. We urge the authorities to continue in this direction so that recovery can get under way and the needed support can be obtained from the international community.

Mr. Almeida made the following statement:

External developments and security problems in Mozambique have played an important role in the decline of production and exports, which have been intensified by the adoption of inadequate pricing policies that have badly affected public finances, as pointed out in the staff report. We should not underestimate the problems that Mozambique is facing at the present time. The gross social product per capita has registered a decline of almost 50 percent in the past five years. It is also significant to note that autoconsumption now represents two fifths of total output compared with one third just six years ago, which reflects the growing disruption of transportation and markets and scarcity of all types of marketed goods and services, particularly foreign imports.

The authorities will need all the perseverance they can muster to pursue their objectives to increase production and to revive international railway and port traffic. Nevertheless, as explained in Mr. Abdallah's opening statement, significant progress has already been made in implementing correct policies, particularly through curbing the previous unlimited access of public enterprises to credit and granting greater flexibility for the management of those enterprises to hire, dismiss, and promote personnel. Much remains to be done, and I agree with the authorities that more flexible approaches should be pursued, particularly in granting a larger role to market forces in the allocation of resources.

I do not see any reason why the use of the structural adjustment facility could not be pursued even without the benefit of a stand-by arrangement. If the only obstacle to a stand-by arrangement is the absence of a reliable statistical base to permit monitoring key economic variables, one should be able to find appropriate proxies. In this respect, I note that the staff was able to produce, for the first time, a medium-term balance of payments outlook for Mozambique. The conclusion of the exercise is not optimistic: the balance of payments position will continue to be dominated by a very heavy debt service burden and its viability will be very difficult to achieve even in the medium term.

The authorities have an urgent need for bilateral aid and strong collaboration between the Fund and the Bank to help them to overcome Mozambique's economic difficulties. We should respond as fast and as generously as possible and intensify our technical assistance to help them implement the comprehensive program they have delineated on pages 14-15 of the staff report, which we strongly support.

The staff representative from the Exchange and Trade Relations Department said that the staff had not been able to link alternative balance of payments scenarios with alternative growth paths partly because of the poor statistical base and the rather dramatic changes in relative prices and the economic organization of the country envisaged under the medium-term program.

It was essential to stop Mozambique's economic decline and to reverse the stagnation of recent years, the staff representative observed. In the long term, it would be desirable to aim at restoring economic activity to a level that approached the relatively good performance of 1980 and 1981. The major uncertainty was the speed with which it would be possible to restore economic activity to that level.

Exchange rate and pricing policies would be designed to improve the efficiency of resource use, the staff representative continued. It would be essential to make maximum use of available resources, which would be extremely limited for the foreseeable future. Because sectoral responses differed, it was difficult to associate a given increase in imports with a given increase in growth. For example, it would be difficult to state that a 10 percent increase in imports would lead to a commensurate increase in activity. Clearly, in the case of agriculture, there was considerable scope for improving production and exports, which would be helpful in improving the balance of payments, provided that pricing policies were correct and that producers received the necessary incentive goods. However, because some industries were highly dependent on imports, it might be necessary to close down some industries that would not be viable in the short or medium term. In that context, it would be difficult to associate directly the overall rate of economic growth with a given balance of payments outcome.

In the staff's view, those points underscored the importance of implementing urgent and far-reaching policy changes, the staff representative said. It was also important to ensure flexible implementation of policies over the medium term.

The existence of a significant differential between the current official exchange rate and parallel market exchange rate was a source of major concern, the staff representative noted. As indicated in the staff report, it was intended that the differential should be eliminated as soon as possible under the medium-term program being discussed with the authorities. Since the other elements of the program were not yet in place, it was not be possible to be more specific. However, the authorities were fully cognizant of the need to take bold action, not only in terms of the initial exchange rate adjustment, but in terms of maintaining flexibility and implementing discrete adjustments during the course of the program period.

Since the consultation mission, further progress had been made on producer price increases to be made following exchange rate adjustments, the staff representative commented. In a number of important areas it would be desirable to adjust producer prices by more than the extent of the exchange rate adjustments, for example, in the case of cashew nuts.

With over 300 enterprises, the public enterprise sector was critical for the economy, the staff representative observed. It would not be appropriate to talk about fiscal, monetary, or pricing policies--or even the balance of payments position--without also taking measures to make those enterprises more profitable or to deal with those that were not viable. In that context, the proposed World Bank study would be extensive and far-reaching, involving very careful consideration of policies affecting each enterprise at the microeconomic level. The most problematic enterprises could be dealt with at an early stage in the structural adjustment arrangement; later stages of the arrangement could incorporate the results of the World Bank study, which he hoped the authorities would act upon.

The staff representative of the World Bank noted that the Bank had been working very closely with the Fund on various elements of the reform program in Mozambique. Several Bank teams were currently in Mozambique assisting the Government in the design of a reform program. One team was working on external and domestic transportation with a view to improving the marketing system. Another team was working on the industrial sector and attempting to work into the system some of the parameters recently developed by the previous Fund team. He hoped that by the end of the month or in early December, the Bank would be able to send a larger team to reach an agreement with the Government on relevant parts of the program.

To some extent, the Bank had had to wait until some of the key macroeconomic issues relating to the exchange rate, the budget, and the interest rate had been addressed. The Bank was speeding up its pace in order to be able to advise the Government in its areas of expertise and to help the Government establish a vigorous program by the beginning of 1987.

The Bank was undertaking a detailed review of nearly 40 public sector enterprises, the staff representative continued. At the outset, it would be necessary to take a general approach in identifying the key areas. The study of specific enterprises would be undertaken thereafter. While the authorities were proceeding with the completion of the study, the actions to be taken during the initial period of the program would be based on available information and agreed policy directions.

Mr. Abdallah reiterated that the new President of Mozambique, in confirming the members of his cabinet in their respective positions, had signaled the international community that the economic reforms should proceed as before. However, he was concerned by the opinion of some of the Executive Directors that Mozambique might be a suitable case for presenting the policy framework paper to the Board before the commitment of resources. In view of the political sensitivities of the situation, he believed that would not be an appropriate course of action. Mozambique had joined the Fund in September 1984, which had not given the authorities enough time to familiarize themselves with Fund procedures. Indeed, they had expected a program to have been concluded with the Fund in December 1985. They had also expected a joint Fund/Bank mission to visit Mozambique to negotiate a structural adjustment arrangement, which had also been been delayed. He was concerned that further delays might have adverse effects, and added that the joint Fund/Bank mission should attempt to conclude negotiations before returning to Washington. In that connection, he was encouraged by the World Bank staff representative's remark that it would be necessary to make do with what information was available. The structural adjustment arrangement should be flexible enough to deal with those problems.

The security problems affected only the southern and western parts of the country, Mr. Abdallah continued. There was great potential for offshore oil that would not be affected by the security situation; and exports of shrimp would not be affected at all. In his view, the real problem was lack of manpower. Since there were only a few people available to cope with a great number of problems, technical manpower provided by the donor community could accomplish a great deal. He strongly urged that the joint Fund/World Bank mission should be given authority to conclude the negotiations to avoid further delay.

The Chairman made the following summing up:

> Executive Directors broadly agreed with the assessment and views expressed by the staff in its report on the second Article IV consultation with the People's Republic of Mozambique. Noting the very large decline in domestic production and trade in recent years,

Directors expressed their deep concern that the economic and financial situation of Mozambique, which had been extremely difficult at the time of the first Article IV consultation, had subsequently deteriorated further. Despite some recovery from the drought, the economy had remained stagnant in 1986 as a result both of the internal security situation and the limited progress made in the past 15 months in implementing corrective policies. Despite the improvements in the collection and processing of statistics since the previous consultation, the data base remained weak, and Directors urged the authorities to continue efforts to provide a better basis for analysis of economic and financial developments and for monitoring the implementation of the adjustment process.

In the view of Directors, Mozambique's economic and financial problems could only be addressed by comprehensive and far-reaching reforms aimed at reversing the deterioration of recent years and establishing the basis for successful rehabilitation and sustained recovery. They were greatly encouraged by the recent indications that the authorities were determined to embark on a major adjustment and recovery program in a medium-term framework. They strongly urged the authorities not to delay implementation of corrective measures; given the size of the imbalances, a number of Directors believed, a gradualist approach would not be appropriate.

Directors stressed the urgency of correcting the major distortions in relative prices and of supporting those measures with tight demand management policies. In that regard, it was considered that a substantial exchange rate adjustment was required at the outset of the policy reform process to help absorb the extensive parallel markets in goods and foreign exchange and shift incentives in favor of productive activity and exports. Directors considered that the initial adjustments should be followed by a flexible exchange rate policy and greater flexibility in the system of price formation with a view to eliminating parallel markets as quickly as possible. Of particular importance would be policies to boost agricultural production--in which Mozambique had obvious potential--and, more generally, to give a larger role to market forces and encourage private initiative.

Directors emphasized the importance of acting strongly to correct budgetary imbalances and of eliminating the current budgetary deficits as soon as possible. The elimination of the parallel markets would contribute to restoring the tax base, which had shrunk dramatically in recent years. Directors also encouraged the authorities to review the tax system. In addition, the authorities were urged to conduct a critical review of current expenditures and to limit outlays to the absolute minimum. A more careful screening of investment projects in the light of financial constraints and efficiency criteria was also seen as priority action.

Directors expressed concern about the high rate of monetary growth and the overhang of excess liquidity in the economy. They urged the authorities to pursue tight credit policies in the context of the envisaged adjustment effort. Substantial increases in interest rates would contribute to the mobilization of savings and to the easing of dependence on quantitative credit controls.

Directors noted with concern that the financial position of public enterprises remained extremely difficult despite the declared intention of the authorities to increase managers' autonomy in cutting costs and raising prices. They emphasized that a substantial improvement in enterprise finances would be a necessary element of the adjustment package. Directors welcomed the forthcoming World Bank study on reform of the enterprise sector and urged the authorities to consider and introduce the reforms suggested on a timely basis.

Directors observed that Mozambique's balance of payments situation and prospects and the heavy debt service burden further underscored the need for early implementation of a meaningful adjustment package. The magnitude of the external constraint highlighted both the likely extended nature of the adjustment and policy reform process and the substantial assistance from the international community that would be required to support that process over the medium term. Early implementation of the initial adjustment measures would establish a basis for resuming discussions with external donors and creditors and encouraging additional concessionary assistance from abroad. Directors concluded that, given the nature of Mozambique's economic and financial difficulties, continued close Fund-Bank collaboration would be required in the context of the medium-term policy reforms envisaged. Directors urged the World Bank to take the lead role in assisting the authorities, both financially and with technical expertise, in a number of areas, including the screening of the public investment program, the reform of the enterprise sector, and the rehabilitation of agriculture, as well as in the elaboration of the policy framework paper to be discussed jointly by the two institutions and the authorities.

It is expected that the next Article IV consultation with Mozambique will take place on a 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to the exchange measures of the People's Republic of Mozambique subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with the People's Republic of Mozambique, in the light of the 1986 Article IV consultation with the People's Republic of Mozambique conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

The Executive Board then took the following decision:

1. The Fund takes this decision relating to the exchange measures of the People's Republic of Mozambique subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with the People's Republic of Mozambique, in the light of the 1986 Article IV consultation with the People's Republic of Mozambique conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The People's Republic of Mozambique continues to maintain restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2. In addition, exchange restrictions evidenced by external payments arrears are subject to approval under Article VIII, Section 2(a). The Fund urges the authorities to adopt adjustment policies that will permit the elimination of these restrictions, and to terminate the bilateral payments agreement that is maintained with a Fund member.

Decision No. 8453-(86/184), adopted
November 17, 1986

2. ANTIGUA AND BARBUDA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Antigua and Barbuda (SM/86/264, 10/27/86). They also had before them a background paper on recent economic developments in Antigua and Barbuda (SM/86/266, 10/31/86).

The staff representative from the Western Hemisphere Department said that the second line of Table 1 of the staff report should have indicated GDP at 1980 factor prices.

Mr. McCormack made the following statement:

Recent economic developments

The economy of Antigua and Barbuda has shown considerable dynamism in recent years. Led by a buoyant tourism sector, real GDP is estimated to have grown by over 6 percent in each of the last four years. In 1985, and again this year, growth was quite broadly based. In addition to a continued rapid expansion of tourism, there was a substantial upturn in construction and agriculture.

Encouraging features of recent economic performance in Antigua and Barbuda are that inflation has been quite moderate and that unemployment appears to be very low. There are no firm data available on employment trends, but a number of sectors are reporting labor shortages.

Problems of economic management

The generally encouraging economic performance of recent years has been clouded somewhat by difficulties in economic management. The implementation and financing of large infrastructural investments, designed to maintain the momentum of growth, has put strains on the public finances and the balance of payments. In particular, there has been a continued accumulation of arrears in the service of external obligations.

At the conclusion of the 1985 Article IV consultation with Antigua and Barbuda, Executive Directors expressed the view that prompt action was needed to strengthen the public finances and to seek means for an orderly settlement of overdue external obligations. Directors also noted that it was essential for Antigua and Barbuda to bring public sector wages under tighter control, not only to improve government finances, but also to foster external competitiveness. My authorities in Antigua and Barbuda fully share those concerns and believe that the stance of policies currently in force is consistent with the broad lines of the Executive Board's recommendations.

With regard to arrears, the authorities have, as the staff report indicates, engaged a British investment banking firm to act as an intermediary in negotiations with the country's four major creditors. Since the staff report was prepared, this issue has been pursued actively and a meeting with the major creditors is being arranged for the first week in December. It is clearly premature to offer a forecast about the likely outcome of these delicate negotiations. However, on the basis of preliminary reactions from the creditors, my authorities are confident that an orderly rescheduling of arrears, on mutually satisfactory terms, can be achieved in the near future.

The authorities believe, as does the staff, that the rescheduling of arrears is only the first step in restoring equilibrium in the public finances and the balance of payments. To remain current and avoid the re-emergence of arrears after the rescheduling requires that the public finances be established on a more sustainable basis, which will involve simultaneously measures to improve revenue performance and to contain the growth of public expenditure. My authorities have asked me to reiterate that they are strongly committed to taking the necessary measures to restore fiscal balance. They believe that the range of fiscal measures recently taken constitutes sound evidence of this commitment.

Public finances

The recent deterioration in the public sector deficit was primarily attributable to substantial increases in public capital outlays associated with two major projects, the building of a hotel complex at Deep Bay and the installation of a desalination cum electricity-generating project. Both these projects were designed to support and reinforce the rapid growth of tourism. Moreover, such projects had to be implemented quickly if the growth of tourism was not to lose momentum. In particular, the experience of 1983-84, when drought required that water be brought in by barges from neighboring Guadeloupe and Dominica, suggested that the water supply project needed to be pushed ahead without delay. Other capital investments, such as road and airport improvements, were similarly motivated by a desire to provide infrastructural support for tourism, the acknowledged engine of growth in the economy of Antigua and Barbuda.

The position of the public sector on current account is relatively encouraging. Public sector saving, although small relative to the large capital expenditures in train, has been consistently positive in recent years, amounting to some 4 percent of GDP in 1985 and almost 6 percent of GDP in 1986.

Over the past two years, the authorities have made considerable efforts to improve revenue performance through a combination of increased tax rates, an extension of the base of the consumption tax, and improved tax administration. Public sector revenues have recorded very substantial increases.

The authorities attach particular significance to the possible revenue effects of the rezoning of suburban properties--referred to in the staff report--that removed a long-standing anomaly, and to the 3 percent stamp duty on loans to nonresidents, which is already having an appreciable revenue impact. The authorities are also optimistic about the probable yields on the undeveloped land tax and on the time-sharing occupancy and services taxes to be introduced shortly. Generally, tax administration has been strengthened by the imposition of penalties for late payment of taxes and by a provision to sequester assets in default of payment. Customs collections have also been improved recently. My authorities note that the staff appraisal recommends that the authorities proceed expeditiously with the reassessment of property values. With the assistance of an outside consultant, a new valuation roll is being compiled and should be complete by April 1987; the revenue effect of the new roll will begin to be felt toward the end of 1987 but will have its first full-year effect only in 1988. Finally, the latest revenue data, as at end September, indicate that revenue this year is running consistently with the achievement of the 1986 targets.

My authorities note--and do not disagree with the staff's judgment--the importance of establishing a firm timetable for the implementation of the planned increase in utility rates over the next four years. Such a schedule has been in existence since 1985 with respect to water rates. There is a defined scheme for telephone rates, with a 10 percent increase being planned for 1987 on existing facilities and with higher rates applying to new, enhanced facilities. On electricity, a socially sensitive item, the authorities have pursued a strategy of passing on to consumers only a fraction of the benefit of lower oil prices.

As to public expenditure, the authorities are pursuing a policy of restraint. For example the Budget Circular issued in July 1986 to all Ministers, Permanent Secretaries, and other heads of division, to serve as a guideline for drafting the revenue and expenditure estimates for 1987, stated, "overall requests for funds for 1987 are to be kept to the barest minimum consistent with provision of adequate services and in any case, that the level of expenditures for 1987 does not exceed the 1986 figure, including supplementary appropriations." My authorities insist that this represents their firm policy intention.

Medium-term outlook

The staff report contains a medium-term projection of the public finances that was prepared with the active participation of the authorities. On the basis of the assumptions made--some of which my authorities now believe may be too conservative--there would be a financing gap of 2 percent of GDP in 1987, increasing to 4 1/2 percent in 1988 before declining to 3 percent of GDP in 1989 and less than 1 percent in 1990. This time profile reflects the once-off, "lumpy," character of the capital outlays that are primarily responsible for the deficits.

A key assumption is that there will be a 10 percent increase in civil service pay in 1987 covering the three years 1987-89. A high-level negotiating team has been established recently to negotiate public sector pay with a mandate to keep increases as low as possible. In the light of the very low rates of inflation recently experienced and given prospects for the coming years, it is believed that it may be possible to negotiate increases below the 10 percent figure assumed in the projections.

Whatever the precise magnitudes involved, the projections indicate that a definite fiscal improvement can be expected in the coming years. This improvement is mirrored almost exactly in a marked turnaround on the balance of payments front. Assuming successful renegotiation of arrears, the implementation of fiscal measures underlying the public finance projection, and a number of specific assumptions detailed on page 13 of the staff report, the current account of the balance of payments is projected to decline from its present high level to less than 2 percent of GDP in 1989; by 1990, the current account is projected to be in balance. The overall balance of payments is expected to show a similar pattern of adjustment, also achieving approximate balance in 1990.

The balance of payments projections exclude the potential capital inflows associated with the sale of the Government's fixed assets. The sale of the hotel at Halcyen Cove and of the condominium units at Deep Bay could be expected to improve the balance of payments picture significantly. There may even be scope for further public sector divestiture. Some consideration is being given to the possibility of selling a number of advance factory shells to potential investors; such sales would permit the Government to clear the loans for factory shell development extended by the Caribbean Development Bank.

Conclusion

The authorities of Antigua and Barbuda recognize that the desire to press ahead rapidly with the development of their economy has given rise to problems. They concur with the staff's general evaluation of the measures required to restore balance in the public finances and the balance of payments. My authorities reaffirm their commitment to take the necessary measures--in addition to those already in place--to bring about financial balance and to avoid the re-emergence of fiscal and external pressures.

Mr. Hospedales made the following statement:

We wish to record our broad agreement with the thrust of the staff's well-balanced appraisal, which describes in sufficient detail the considerable progress made by Antigua and Barbuda in achieving its objective of growth and employment as well as in containing its internal and external balances. For a number of years, Antigua and Barbuda has had sound economic growth rates within an environment of financial and price stability. The record is impressive and commendable. Inflation has decelerated markedly, wage settlements have moderated, and unemployment has almost disappeared. In our view, there is no doubt that the standard of living of the population has improved substantially. Since 1982, growth in output has averaged 6.5 percent a year and real income has grown even faster, reflecting terms of trade improvements. Growth has been encouraged by the strong backward sectoral linkages forged by the tourism sector--the main impetus for the economy's satisfactory performance.

Notwithstanding those developments, we agree with the staff that there remain several points of vulnerability that must be addressed. The growth in external arrears is the principal area of concern. Underlying this phenomenon is the emergence of weaknesses in public finances stemming from the massive public investments that are currently being undertaken. Accordingly, under the circumstances, Antigua and Barbuda is correct in pursuing a medium term economic strategy that aims at restructuring production, enhancing the growth of the economy's debt servicing capacity, and keeping domestic expenditure and the balance of payments under strict control. We feel that the authorities' attempt to restructure their external arrears to provide some breathing space is broadly appropriate. Therefore, creditors should give early consideration to their request for rescheduling existing arrears, which in our view will allow for the orderly settlement of arrears and will facilitate the resumption of access to concessional resources, including World Bank lending programs.

We view the four major projects under implementation--desalinization/power plant, Deep Bay Hotel, airport runway resurfacing, and telecommunications upgrading--as key elements in the furtherance of the authorities' economic strategy. We concur with the authorities' focus on the exploitation of the locational advantages of the tourism sector. It is essential to maintain the momentum of the tourist industry-led economic growth to provide a sound basis for the transformation of the economy. In our view, this process is essential in order to reduce the country's vulnerability to shocks stemming from its structural dependence on a single industry--tourism--for the bulk of fiscal and foreign exchange revenue.

The authorities' objectives of tight demand management and restoration of external creditworthiness are being pursued in the medium term through revenue enhancement and expenditure containment. Obviously, Antigua and Barbuda's membership in the regional East Caribbean Central Bank has reduced significantly the scope for an independent monetary and exchange rate policy, which makes the pursuit of a cautious wage policy an extremely important objective for maintaining the economy's international competitiveness.

The medium-term fiscal adjustment program has yielded significant benefits. Public sector savings for 1986 will amount to 5.5 percent of GDP, an increase from the annual average of 2.6 percent of GDP over the past three years. It should be noted that the substantial rise in the overall public sector deficit is associated with the tourist-related infrastructure, the bulk of which is foreign-financed on commercial terms. We note with satisfaction that there will be higher public sector savings and overall surpluses on fiscal accounts with the sharp reduction of capital expenditures after 1988 to levels comparable to the 1983-85 period. However, debt service payments are projected to be very high in 1986--about 19.5 percent of exports of goods and services--and thereafter to decline significantly. We are encouraged, therefore, by the authorities' commitment to take the measures necessary to restore long-term fiscal balance and to avoid the emergence of new arrears.

Mr. Foot made the following statement:

As Mr. Hospedales has pointed out, although there are a number of very promising features of the Antiguan economy, the size of the two projects--the Deep Bay Hotel complex and the desalinition plant--currently being undertaken by the authorities is extremely large relative to the size of the economy. Given the type of risks to be expected in such a situation, it is critical that those projects succeed. It is of some concern, therefore, to see in the staff report that the World Bank has reservations about the criteria used in the selection of development projects. The accumulation of external arrears in such a situation is a particularly worrisome feature.

It is encouraging to note that the authorities are clearly anxious to regularize their external position, and my Government's export credit agency awaits their proposals with interest. It is clear that the authorities are coming to grips with the fiscal position, and we hope that we will soon have news that they have made considerable progress in that regard--certainly by the next Article IV consultation. Since it will not be easy to regularize the external position, I would appreciate staff comment on the outlook for merchandise exports, which I believe have fallen by 50 percent over the past four years. I am also curious about the source of the fairly substantial increase of exports indicated in the staff projections, given the current exchange rate environment.

I think it is appropriate that the authorities have requested a 12-month consultation cycle, which I fully endorse.

Mr. Hodges made the following statement:

Two conclusions seem to stand out in the staff report on Antigua and Barbuda: first, although their severity has increased, the problems facing the economy have changed little since the 1985 Article IV consultation; and second, a strengthening of public sector financial policies will be the key to achieving a sustainable improvement in the economy's performance.

Economic performance since the 1985 consultation has been disappointing in a number of areas. The fiscal deficit has widened and despite Directors' recommendations to the contrary, the authorities have continued to rely on a buildup in arrears to finance the balance of payments deficit and have contracted significant new external debt on commercial terms.

The authorities have had the leeway to pursue these policies and defer necessary adjustment largely because of relatively strong economic activity, low inflation and unemployment, and steady improvement in the terms of trade in recent years. This economic growth, however, has been achieved at the cost of a substantial increase in external indebtedness and impaired international creditworthiness, putting at risk future economic growth. The unwillingness of the World Bank to make any direct loans to Antigua and Barbuda can be taken as an indication of the harm that the authorities' current policy stance has caused.

Restoring the country's creditworthiness and strengthening the public sector finances, therefore, remain the major priorities. The importance of fiscal policy is reinforced in Antigua and Barbuda's case by the limited scope for an independent monetary and exchange rate policy. The restoration of international creditworthiness will require an orderly settlement of overdue financial obligations and the avoidance of new external commercial debt for the present.

I support the main policy recommendations outlined in the staff report. As to fiscal policy, I am pleased to note from Mr. McCormack's opening statement that the authorities agree with the staff's recommendations concerning the reassessment of property values and the need to establish a firm timetable for the implementation of the planned increases in utility rates, which they have already begun to implement.

I welcome the authorities' intention to maintain restraint of current expenditures, and would urge them to make efforts to contain the 1987 public sector wage increase to less than 10 percent. In the light of the World Bank's reservations about the selection of investment projects, I urge the authorities to carefully monitor the locally financed capital outlays included in the 1986-88 public sector investment program.

I welcome the authorities' decision to seek a rescheduling of outstanding arrears and their intention to ensure that fiscal adjustment will be sufficient to avoid the emergence of new arrears after the rescheduling operation is concluded.

The economy of Antigua and Barbuda has a number of very positive features, including the prospect of continuing low inflation and unemployment and an expected increase in tourist activity. If the authorities are able to address the current fiscal and debt management problems promptly, they should be able to look forward to an early return to a satisfactory economic performance.

Mrs. Walker made the following statement:

Antigua and Barbuda's economy has shown signs of progress in the past few years, with real GDP increasing by over 6 percent, inflation declining substantially, and wage increases moderating from the high levels in 1982. However, upon examination of the fiscal accounts, the bright picture dims considerably and it becomes clear that the high levels of real growth in the economy have been achieved at the cost of substantial borrowing by the Government, financed in part by external arrears. As both the staff report and Mr. McCormack have stated, at the discussion of the 1985 Article IV consultation (EBM/85/88, 6/3/85), the Executive Board had warned the authorities about the growing fiscal problem and had urged them to strengthen public finances and settle the external overdue obligations. Unfortunately, during 1986, the fiscal position of the Government has weakened sizably, with projections for an overall deficit of 36 percent of GDP. The stock of external arrears is expected to reach 15 percent of GDP by the end of 1986.

Clearly, the fiscal position of the Government cannot be sustained. The high level of external overdue obligations will hinder Antigua's access to traditional concessional financing and force the authorities to borrow on nonconcessional terms. Although we understand the authorities' desire to construct the turnkey hotel complex and the desalination plant, the level of borrowing necessary to finance those projects will require more fiscal action on other fronts than has been acccomplished thus far.

In his opening statement, Mr. McCormack said that the authorities have recognized the need for settlement of current arrears and subsequent measures to improve the sustainability of public finances thereafter, and that they are strongly committed to taking the necessary measures to restore fiscal balance. We welcome those assurances and urge the authorities to move expeditiously to implement the revenue measures mentioned in the staff report, including increases in utility rates, which have already been started, the reassessment of property values, and the sale of government-owned hotels and condominiums. Expenditure restraint wll be equally important, particularly regarding wages and locally financed capital outlays. We also urge the authorities to avoid the contraction of new debt on commercial terms until the public sector's financial position is stable and the policy of developing arrears ends.

As to the proposed debt rescheduling, the United States is certainly open to holding discussions with the authorities. However, we must reiterate that our standard practice is to reschedule in a multilateral framework with associated conditionality. In light of the uncertainty of the rescheduling arrangement, it would be helpful if staff commented on the outlook for the country without such an agreement and what additional measures they would consider necessary.

We welcome the authorities' intention to regularize their pay ments schedule in the future. A sound fiscal policy will be essential to the future development of the economy and we urge the authorities to follow through with their plans.

The staff representative from the Western Hemisphere Department said that the outlook for merchandise exports in Antigua was limited because tourism was the main industry. The average costs in the country tended to be higher than those of other competitors in the Eastern Caribbean area. There was some possibility for increased exports of agricultural products such as winter vegetables, which could also serve as a substitute for imports by the tourist industry. There were also possibilities for manufactured exports, but those were more restricted because of the relatively high costs of production. The most promising avenue for increasing exports appeared to be in the area of nontraditional agricultural exports. A recent crop, cotton, appeared to be very promising, but the industry suffered from lack of adequate labor. In contrast to the limited opportunities in other areas, the outlook for tourism appeared to be extremely promising.

As to the fiscal outlook and the debt service profile, the staff representative said that the absence of debt rescheduling would have two effects. First, if the stock of arrears estimated at $30 million was not rescheduled, interest would accrue on the unpaid amount. Second, if the debt rescheduling did not take place, the interest that had been put into the balance of payments as interest on rescheduling operations would not be paid. Thus, for the grace period--1987-88--it was expected that the interest that would accumulate as capitalized interest owing on the unpaid arrears would roughly compensate for the interest that would have been paid had the rescheduling taken place; the gap for those two years would remain approximately the same as projected by the staff. However, in 1989 and 1990, when the authorities would begin making amortization payments on the rescheduled arrears, two situations could arise: if the amortization of payments, projected at $3.9-4 million annually, were applied to the reduction of the outstanding stock of arrears, then the financing gap would remain as projected; however, if the arrears continued to increase by the amount of capitalized interest, the gaps would be reduced by the same amount, approximately $4 million annually for 1989-90.

In the current circumstances, the involvement of the World Bank was fairly limited in Antigua, the staff representative commented. Although the Bank had indirectly provided assistance to Antigua through the Caribbean Development Bank, further operations were not anticipated in the near future. Furthermore, because of its high per capita income, Antigua was not eligible for a structural adjustment arrangement from the Fund, which was one of the areas where the Fund had the most active collaboration with the Bank. Thus, a World Bank representative had not been invited to attend the Board discussion on the 1986 Article IV consultation.

Mr. McCormack said that he would convey to his authorities the very deep concern that had been expressed about the existence of arrears. Although the proposed debt rescheduling was being conducted bilaterally, the authorities intended to respect the principle of comparability of treatment throughout the negotiations. With respect to the criticism of the project appraisal process in Antigua, he pointed out that the USAID project providing technical assistance to improve project evaluation in Antigua had begun three weeks previously.

The Chairman made the following summing up:

Executive Directors were in general agreement with the thrust of the staff appraisal in the report for the 1986 Article IV consultation with Antigua and Barbuda.

Directors noted that in recent years the economy had registered high rates of growth--spearheaded by large increases in tourism and related industries--and low rates of inflation and unemployment. Also, they welcomed the measures taken by the authorities, which had resulted in a steady increase in public sector savings. However, Directors observed that, in spite of those efforts, the public finances had remained weak, partly as a result of the execution of large investment projects financed from abroad at commercial terms, and the buildup of arrears on the external debt had continued. They stressed that prompt and decisive action was needed to place the public finances on a sound footing and to halt the buildup of arrears.

Directors noted that the proposed rescheduling of existing arrears would be an important first step toward the regularization of Antigua's debt servicing. However, they stressed that the rescheduling would need to be set in a multilateral context and in the framework of a comprehensive set of adjustment policies. In that regard, additional measures to strengthen the public finances were clearly warranted. They urged the authorities to take further steps to bolster revenue and, more importantly, to exercise restraint on current expenditure, especially on wages.

Directors also emphasized the need to establish strict priorities for investment projects that were large in relation to the size of the economy and to adopt the necessary measures to ensure the timely servicing of the related debt. In particular, Directors urged the authorities to implement promptly a timetable for the increase in utility rates, to reassess property values for tax purposes, and to improve tax administration. They also recommended the avoidance of new debt on commercial terms.

Given the influence of public sector wages on the behavior of wages throughout the economy, Directors noted that caution in the granting of wage awards to public sector employees would not only restrain expenditure growth, but also would help maintain the country's competitiveness and permit the external sector to sustain the strong growth recorded in recent years.

The authorities have requested that the next Article IV consultation with Antigua and Barbuda be held on a 12-month cycle, rather than on the 18-month cycle previously in effect.

3. MEXICO - REPORT BY THE STAFF

The Associate Director of the Western Hemisphere Department, reporting on the financing arrangement for Mexico, said that the amount pledged by banks to the package was currently a little over $6.3 billion out of the total of $7.7 billion being sought, or approximately 82 percent of the total. The authorities and the commercial bank Advisory Committee were pursuing various avenues in order to reach the critical mass.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/183 (11/17/86) and EBM/86/184 (11/17/86).

4. NIGER - TECHNICAL ASSISTANCE

In response to a request from the Nigerien authorities for technical assistance in the fiscal area, the Executive Board approves the proposal set forth in EBD/86/298 (11/12/86).

Adopted November 17, 1986

APPROVED: July 1, 1987

JOSEPH W. LANG, JR.
Acting Secretary