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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/58

10:00 a.m., April 12, 1985

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

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. K. Bush
	G. Ercel, Temporary
B. de Maulde	X. Blandin
	T. Alhaimus
	M. Sugita
G. Grosche	
	T. Sirivedhin, Temporary
	L. Leonard
	J. R. N. Almeida, Temporary
	H. Fugmann
	A. Abdallah
	C. A. Salinas, Temporary
	J. E. Suraisry
	J. de la Herrán, Temporary
	J. de Beaufort Wijnholds
	H.-S. Lee, Temporary
G. Salehkhou	
	A. S. Jayawardena
	T. A. Clark
	N. Coumbis
	Wang E.

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

Also Present
P. Landell-Mills, Western Africa Regional Office, IBRD. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; E. A. Calamitsis, M. Dairi, S. M. Nsouli, M. Sidibé, A. Tahari. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director, E. H. Brau. Fiscal Affairs Department: B. A. Sarr, A. Tazi. Legal Department: Ph. Lachman. Research Department: W. C. Hood, Economic Counsellor and Director; J. Artus, H. H. Zee. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: L. K. Doe, E. M. Taha, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, W.-R. Bengs, J. Bulloch, C. Flamant, A. K. Juusela, M. Lundsager, R. Msadek, A. Mustafa, J. K. Orleans-Lindsay, W. Parmena, J. E. Rodríguez.

1. GROUP OF TEN - DEPUTIES' MEETING - REPORT BY STAFF

The Economic Counsellor reported that the Deputies of the Group of Ten had met in Paris on April 10-11, 1985 to discuss two chapters of the draft report to the Ministers on the evolution of the international monetary system, those on the functioning of the floating exchange rate system and on the management of international liquidity. The Deputies expected to complete their review of the report at a meeting to be held May 15-16 in Basle and to present the report to the Ministers and Governors of the Group of Ten at the ministerial meeting to be held in Tokyo on June 21, 1985. It was also expected that, at the forthcoming economic summit to take place in Bonn in early May, the German Finance Minister, Mr. Stoltenberg, would present a status report on the work of the Deputies, but without entering into the substance of the report.

2. MAURITANIA - STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on Mauritania's request for a one-year stand-by arrangement in an amount equivalent to SDR 12 million (EBS/85/41, 3/1/85; Cor. 1, 3/4/85; and Sup. 1, 4/9/85).

Mr. Alfidja stated that the 1984 Article IV consultation with Mauritania, concluded by the Executive Board on December 10, 1984 (EBM/84/180), had taken place against the background of the authorities' resolute efforts to continue implementing adjustment measures to overcome the difficult economic and financial situation that the country had been facing for a number of years. The large domestic and external financial imbalances were mainly due to the protracted and severe drought, which had led to a substantial decline in agricultural output and losses in the livestock sector. Mauritania's economic and financial difficulties were also the result of a decline in world demand for iron ore--the main export commodity--a deterioration in the terms of trade, and a worsening in the operations of the public enterprise sector.

Following the measures initiated in 1983 to arrest the deteriorating economic and financial conditions, Mr. Alfidja continued, in 1984 the authorities had pursued restrained fiscal and credit policies, continued the reform of the public enterprise sector, and significantly depreciated the ouguiya. The fiscal measures taken had helped to achieve a substantial reduction in the deficit on treasury operations on a commitment basis from 4.7 percent of GDP in 1983 to 1.8 percent of GDP in 1984. The pursuit of a tight credit policy had resulted in a further decline in the rate of credit expansion to 8.6 percent in 1984, compared with 10 percent in 1983 and an average annual rate of 18 percent during the period 1980-82. In the external sector, the current account deficit had widened from 28 percent of GDP in 1983 to 34 percent of GDP in 1984 because of unpredictable developments in both import and export performance. The financing of the overall balance of payments deficit had resulted in a further accumulation of arrears, estimated at SDR 93 million at the end of 1984.

In the light of the mixed results of the adjustment measures implemented in 1984, Mr. Alfidja added, the Mauritanian authorities had decided to strengthen their efforts by initiating a comprehensive, strong financial program for 1985 as a further step toward achieving a viable balance of payments position by 1990. As elaborated in the letter of intent and its annexed memorandum from the Mauritanian authorities, the program's objectives were to revive economic activity in order to attain a rate of growth in real GDP of 3 percent, limit the rate of inflation to 12 percent, and reduce external imbalances.

In the fiscal area, the authorities planned to continue their policy of restraint to contain the growth in current expenditure, raise more revenues, and reduce further the deficit on treasury operations--including scheduled interest payments--from 1.8 percent of GDP in 1984 to 0.8 percent of GDP in 1985, Mr. Alfidja noted. To that end, several tax measures had been introduced in the 1985 budget to supplement those implemented in 1984, in order to achieve a projected increase in domestic revenue of 19 percent. The new revenue-raising measures included changing specific duties on items such as tobacco, milk, and edible oil to an ad valorem basis, and the harmonization of customs duties with those of the Community of West African States. The authorities would continue to strengthen tax administration by focusing on the collection of taxes on wages and salaries, the general income tax, and tax arrears. They had initiated in-depth studies on the tax exemption system, the customs tariff, and tax collection in the fishing sector. Expenditure controls would be tightened, and developments in capital spending would be closely monitored.

To correct distortions and eliminate weaknesses in pricing policies as well as to stimulate economic activity in the private sector and improve resource allocation, Mr. Alfidja continued, the authorities were determined to pursue liberal pricing and marketing policies under which both agricultural producer prices and official prices for consumer goods, public utilities, and petroleum products would be gradually increased. Accordingly, on February 15, 1985, the Mauritanian authorities had raised the prices of sorghum, maize, and wheat at the wholesale and retail levels by 50 percent and 40 percent, respectively. Similarly, the producer price of paddy rice had been increased at the wholesale and resale levels by 30 percent and 12 percent, respectively.

The reform of the public enterprise sector, which had been initiated in late 1983 with technical and financial assistance from the World Bank and other international and regional financial institutions, would be continued under the 1985 program, Mr. Alfidja remarked. A unit had been formed in the Ministry of Planning to monitor the implementation of the reform, and other monitoring units were planned for the technical ministries in 1985. To help in preparing for the rehabilitation of other enterprises such as the food aid agency and the oil marketing agency, the auditing of public enterprises would be speeded up in 1985. On the basis of the audit report, a time frame for the settlement of indebtedness among the enterprises, the Government, and the banking system would be established.

Consonant with the objective of attaining sustainable economic growth over the medium term, Mauritania's investment program in 1985 focused on rehabilitation of existing infrastructure and on quick-yielding projects in agriculture, Mr. Alfidja noted. Investment had been sharply reduced by 44 percent to conform with the economy's absorptive capacity, the availability of financial resources, and the stand-by program's fiscal and balance of payments objectives.

In support of their policy of fiscal restraint and to improve the external payments position, the authorities would continue to pursue a restrictive monetary policy, Mr. Alfidja went on. In that connection, total credit expansion would be reduced from 8.6 percent in 1984 to 5 percent under the program, with priority being given to the nongovernment sector, mainly for agriculture, fishing, and mining.

The Mauritanian authorities were aware that domestic and external financial imbalances were likely to persist for a long time, and they regarded the pursuit of a flexible exchange rate policy as an important element of the economic and financial policies being implemented, Mr. Alfidja commented. On February 15, 1985, they had therefore further depreciated the ouguiya, reversing its appreciation since 1980 and eliminating all broken cross rates.

His authorities shared the staff's view that the pursuit of strong adjustment policies in the years to come was essential for a gradual restoration of financial and economic balance, Mr. Alfidja remarked. It was also their opinion that continued external assistance and favorable exogenous circumstances such as good weather would be of paramount importance in their struggle to improve the country's economic welfare. In that context, they appreciated the multifaceted external assistance granted to Mauritania thus far. Finally, considering the strength of the adjustment effort under way, the use of foreign financial and technical aid would be greatly enhanced if higher-quality human resources were available locally.

Mr. de Maulde said that he supported Mauritania's request for a stand-by arrangement. Since the Board's previous discussion of the Mauritanian economy in December 1984, the authorities had embarked on a major adjustment effort, and the comprehensive program in support of the stand-by arrangement appeared to be realistic, courageous, and fully deserving of Fund support.

The measures constituting the program had already been implemented to a large extent, Mr. de Maulde observed. In the fiscal field, the authorities had made a major effort to limit the growth of the wage bill, with a freeze on the size of civil service employment and a 2 percent increase in salaries. With an inflation rate of 12 percent in 1985, the purchasing power of civil servants--which had already declined over the past four years--would decline by a further 10 percent. Such action was never easy, and he commended the authorities for the commitment that it reflected.

Major supply-oriented measures had also been taken following a sizable devaluation to ensure a full passthrough of its effects on a number of prices, including those of basic staples such as sorghum, maize, wheat, and rice, Mr. de Maulde continued. However unpopular such measures were, they were nevertheless indispensable to improving the public finances and providing better incentives to the agricultural sector. To foster a quick supply response, the Government--with the assistance of the World Bank--had started the rehabilitation of key public enterprises and had already streamlined the public investment program in order to achieve better resource allocation.

The adjustment measures, which covered the whole range of economic policies, went in the right direction toward achieving the progressive reduction of unsustainable balance of payments deficits, Mr. de Maulde considered. The staff projections showed that a viable balance of payments position could be attained by the end of the decade, provided that there was continuous adherence to strict adjustment policies. However, the sizable financing gaps that would persist over the same period would have to be filled by creditors in the framework of the Paris Club or other forums, and by donors through continuous support in the form of official development assistance, on terms that would have to be strongly concessional.

In that context, Mr. de Maulde noted, the amount of Fund support, which had been limited to 35 percent of Mauritania's quota, would result in a net repayment to the Fund of SDR 0.8 million during the program period. As Fund charges would equal some SDR 3 million, there would be a net transfer of resources to the Fund approximating SDR 4 million in 1985. At a time when the international community was being asked to make major efforts to increase its exposure in order to help Mauritania--through both restructuring of debt and new, substantial commitments of concessional finance--it was regrettable that the Fund was not giving the right signals. In effect, part of the assistance extended to Mauritania would be used to reduce the Fund's own exposure, an outcome that would not appear appropriate.

As to the assumptions underlying the balance of payments projections, Mr. de Maulde remarked, there was more scope for improvement in the fishing sector than the staff had assumed. It was well known that, off the coast of Mauritania, the cold waters that formed the Canary Current were among the richest fishing grounds in the world. It was also well known that over a number of years a sizable part of the catch had been unofficially exported, with a corresponding loss of export revenues for Mauritania.

The measures taken in the fishing sector by the Mauritanian authorities since 1982 had allowed for an increase of declared exports to 312,000 tons in 1983, Mr. de Maulde added. Nevertheless, according to various sources, the amount of unrecorded exports was still estimated at between 100,000 and 300,000 tons. Even at the lower figure, action to suppress those illegal exports would bring about a $50 million increase in export receipts, and would increase government revenue by approximately 6 percent. Such action was therefore urgently needed, because it would at the same time reduce the amount of external assistance needed to close the financing gap and, consequently, the amount of Mauritania's debt. He invited the World Bank representative to comment on that matter and to indicate what action the Bank was considering and above all when it would act.

In concluding, Mr. de Maulde reiterated his support for the program to be supported by the arrangement, but urged the Executive Board to reconsider the level of Fund support.

Mr. Suraisry endorsed the main points in the staff appraisal and supported Mauritania's request for a stand-by arrangement.

Mauritania clearly faced serious economic and financial problems, Mr. Suraisry remarked. Growth was weak, and the economy was performing well below its potential. There were large imbalances in the fiscal and external accounts, and domestic and external arrears were high. Those problems were due in part to factors beyond the authorities' control, such as the severe drought, as well as to the pursuit of inappropriate domestic policies in recent years.

The firm measures that the authorities had already taken to stabilize the economy underlined the authorities' commitment to adjustment, Mr. Suraisry noted, and the proposed program appeared well designed to address the immediate problems. Like the staff, however, he considered the program to be only a first step; the restoration of a viable external position would require a sustained adjustment effort for some years to come.

The program's emphasis on fiscal restraint was welcome, Mr. Suraisry added. The combination of measures to raise revenue and control expenditure should help to reduce domestic arrears and bring the budget deficit down to a more sustainable level. The decision to limit wage increases in the civil service was both appropriate and courageous. He encouraged the authorities to explore all possible avenues for further restraint in current spending and for strengthening tax administration.

Continued efforts to restructure the public enterprise sector were also vital to strengthen the Government's finances and enhance domestic saving, Mr. Suraisry noted. Although some progress had been made, further action was needed, particularly to deal with the problem of interlocking debts among the public enterprises. He noted with satisfaction that the authorities were working closely with the World Bank to devise a comprehensive rehabilitation program for those enterprises.

Fiscal restraint should be supported by a cautious monetary policy to keep inflation under control, Mr. Suraisry considered. The proposed monetary targets appeared consistent with the program's broader objectives, and he supported the intention to channel credit to priority sectors and to encourage exports. He also welcomed the recent measures to strengthen the banking system; the authorities should carefully consider the recommendations of the study being undertaken with the assistance of the Arab Monetary Fund.

He fully supported the supply-side measures taken to stimulate private sector activity and to promote agricultural production, Mr. Suraisry commented, as well as the moves to adjust domestic prices to improve incentives. He also noted that the results of the study to reform domestic pricing and marketing policies should be available by the time of the midterm review. Sustained growth would also require a well-designed public investment program to complement the activities of the private sector. It was therefore encouraging that the authorities were drawing up a medium-term investment plan with the assistance of the World Bank. He welcomed their intention to bring public investment more into line with the economy's absorptive capacity and to concentrate on quick-yielding projects with high rates of return.

The recent devaluation and the shift to a flexible exchange rate policy should strengthen Mauritania's competitive position, Mr. Suraisry concluded. Sustained export growth was essential for Mauritania to eliminate arrears and normalize relations with its creditors. Even under favorable assumptions, however, Mauritania would continue to require external assistance for some time to come. That likelihood underscored the crucial role of the Fund as a catalyst and of the importance of continued adjustment by Mauritania over the medium term.

Ms. Bush stated that the medium-term outlook for Mauritania showed that the need for comprehensive adjustment was paramount. The proposed program under the stand-by arrangement provided support for such an effort by including a wide spectrum of adjustment measures--some already implemented--aimed at stimulating domestic production while reducing financial imbalances. The goals of the program were quite ambitious: the current account deficit was projected to fall from over 33 percent of GDP in 1984 to 14 percent in 1985, the overall fiscal deficit was expected to be halved to 4.2 percent of GDP on a commitment basis, and all external and known domestic arrears were to be eliminated. Achievement of those targets could lay the foundation for the several years of further adjustment that would be required to return Mauritania's external accounts to a sustainable basis.

The exchange rate measures taken in February 1985 had completely reversed the appreciation of the ouguiya that had occurred since 1980, Ms. Bush observed. She noted with satisfaction that the authorities would follow a flexible exchange rate policy.

Tighter control over both current and capital expenditure should result in a great deal of adjustment on the fiscal side, Ms. Bush continued. She welcomed the emphasis on limited nominal wage increases in the public sector, the capping of the size of the civil service, and the restraint in spending on subsidies. Nevertheless, in the longer term, actual decreases in such spending probably would be required, since containment of the public sector was necessary to attain the long-term goals of effectively managing aggregate demand. Also, public investment was being appropriately reoriented toward the rehabilitation of existing capital stock with new projects emphasizing the productive sector. World Bank assistance in setting priorities within the financial and economic constraints facing Mauritania was welcome.

As to the public enterprises, Ms. Bush remarked, the emphasis on reform in the five major enterprises was welcome; that reform should be broadened to include all public enterprises. Particular attention should be paid to appropriate pricing policies, not only to reduce the budgetary costs of subsidies and transfers but also to encourage more efficient resource use. She therefore welcomed the apparent divestment by the rural development agency of some of its activities. As for the oil marketing agency, more reliance on private sector distribution and marketing should be considered.

The February producer price increases and the planned full passthrough of exchange rate adjustments were welcome, Ms. Bush commented. Moreover, a study was under way on increasing reliance on market determination of prices, and agreement was to be reached at the first review on the implementation of price liberalization measures. The Mauritanian authorities should move steadily toward increasing substantially the flexibility of their pricing system. The prices of imported food received as grants should also be increased, even though there was no foreign exchange cost. Domestic food production must be encouraged--weather permitting--and price signals were the most effective means of shifting consumption away from imports and thus stimulating demand for domestically produced foodgrains.

Monetary policy appeared to be well under control, with restrained credit expansion, Ms. Bush observed. Such restraint implied a low level of credit to the private sector in order to contain inflation further following the exchange rate adjustment, but the expected reduction of the Government's domestic arrears would perhaps provide the private sector with needed cash.

As a low-income country facing balance of payments financing gaps through the end of the decade, Mauritania would continue to have a large debt servicing burden, Ms. Bush noted, rising to 50 percent of exports of goods and services in 1986 and falling only to 26 percent in 1990. The debt service associated with Fund borrowing was also significant. It would therefore be prudent for Mauritania to finance its balance of payments gap with concessional assistance to the extent possible. The proposed size of the stand-by arrangement was consistent with the effort to emphasize reliance on concessional assistance; repayment of larger purchases might have contributed to Mauritania's difficulties by absorbing foreign exchange that could preferably be used for imports.

The Mauritanian authorities should increase their efforts to attract foreign investment so as to strengthen the capital account, Ms. Bush remarked. According to Appendix Table 1 of the staff report, the category of other capital inflows, which covered several items, had declined from SDR 35 million in 1982 to an expected SDR 10 million in 1985. She would be interested in staff views on the possibility of generating higher than projected capital inflows. In concluding, she supported the proposed decision.

Mr. Leonard stated that Mauritania's future prospects depended crucially on the authorities' relentless pursuit of strong adjustment. Present imbalances in the economy were considerable and were deeply rooted. Since 1982, the consolidated government deficit, amounting each year on average to almost a fourth of GDP, had been largely financed by foreign grants and loans. Gross domestic savings had been negative compared with average gross domestic investment on the order of 35 percent of GDP annually. The external accounts reflected the domestic imbalances, with large successive current deficits being financed by public transfers, external borrowing, loss of revenues, and the accumulation of arrears. Practically alone among major indicators, price movements--whether in the form of the GDP deflator or as represented by the consumer price index--though by no means negligible, had at least been within reasonable limits, but it was difficult to assess the significance of either of those indicators in Mauritania's circumstances.

The extent of the task facing the authorities in the elimination of those imbalances could be roughly gauged from the staff's medium-term scenario, Mr. Leonard remarked. It suggested that even on the basis of favorable assumptions concerning the growth of exports, movements in export prices, and weather, four to five years of rigorous management of aggregate domestic demand would be required to bring the current external deficit to a more manageable level. There would be little room for increases in per capita consumption, especially of imported consumer goods, and investment would have to be carefully managed so as to keep it within narrow limits but at the same time maximize growth. The debt service ratio would rise to some 50 percent in 1986 and by 1990 would still be about 25 percent. In each year after 1985, a sizable but diminishing financing gap would remain that would require the continued goodwill and cooperation of the international financial community if it were to be bridged. If the favorable assumptions underlying those prospects did not turn out to be well founded, the picture would darken correspondingly.

Despite the uncertainties about the course of economic developments, Mr. Leonard commented, the Mauritanian authorities were making a courageous and good beginning in the restoration of economic balance under the present program. He agreed with the general thrust of present policies and was encouraged by what had already been done in 1984. He also noted with satisfaction the arrangements made at the meeting of creditors and donors held in Paris in March for financing the 1985 balance of payments gap.

As to the stand-by arrangement itself, Mr. Leonard noted, the performance criteria for fiscal and monetary performance and for external debt management were demanding, but correctly chosen. The two reviews, also included as performance criteria, should enable the Board to follow developments closely and modify the arrangement if necessary. In concluding, he supported the proposed decision.

Mr. Grosche remarked that it was clear from the staff paper that Mauritania's serious economic problems had been caused largely by inappropriate economic and financial policies. Fiscal and monetary policies had been too expansionary, exchange rates and pricing policies had been inappropriate, and the investment program had been ambitious but economically inefficient. Nonetheless, he recognized that exogenous factors had also played an important part in the recent critical deterioration of the economic situation.

The corrective measures taken by the authorities in 1984 had been insufficient to redress the situation, Mr. Grosche continued, and the already severe external and internal imbalances had intensified further. The authorities' intention to address decisively the deep-seated structural problems by implementing a number of comprehensive and firm adjustment measures was therefore welcome. The measures seemed to be generally adequate to achieve the objectives of the stand-by program; indeed, they were largely in line with the recommendations made by the Board at the conclusion of the 1984 Article IV consultation with Mauritania. He also welcomed the authorities' close cooperation with the World Bank in designing the necessary structural adjustment measures.

It was reassuring that several measures had already been put in place, such as the overdue depreciation of the exchange rate as well as the increases in prices and interest rates, Mr. Grosche added. It was also reassuring that the authorities were willing to take any additional measures that might become necessary to ensure that the program's targets would be attained.

The authorities' clear commitment to implementing determined adjustment measures in a medium-term framework would be decisive in gaining the necessary support of donors and creditors, who would be asked to provide the resources needed to fill the large--albeit narrowing--balance of payments gaps in coming years, Mr. Grosche considered. With a strong adjustment program in place and with firm indications at hand that additional resources would be provided to finance the balance of payments gap in 1985, all the requirements were at present fulfilled for the Board to grant approval of the stand-by arrangement. Thus, the Fund had again successfully played a key catalytic role in putting together a comprehensive adjustment program and, at the same time, a financial package.

Although the projected stance of monetary policy seemed to be adequate, the present interest rate structure was not fully satisfactory since interest rates on deposits were still negative in real terms despite the recent increase, Mr. Grosche went on. Real negative interest rates were unlikely to increase domestic savings substantially, a regrettable prospect considering the need to increase the share of domestic financing in investment.

He welcomed the depreciation of the exchange rate and the elimination of all broken cross rates, Mr. Grosche continued. The intention to pursue a flexible exchange rate policy would be a critical factor in attaining the balance of payments targets. He wondered, however, whether the projection of a continued improvement in the trade balance, which was based on a continuous rise in export earnings, was realistic. Moreover, was the projected near constancy of interest payments on external debt from 1986 to 1990 realistic, since the external debt was scheduled to rise further? He invited staff comment on those points.

The projected improvement of the fiscal position on the expenditure side would be brought about mainly through a sharp cut in investment outlays, Mr. Grosche noted, whereas current expenditures were projected to rise substantially. He wondered whether that approach to cutting the fiscal deficit was fully appropriate.

While he supported the proposed decision, Mr. Grosche also expressed his strong expectation that the remaining part of the balance of payments financing gap for 1985 would be fully covered by additional assistance, as indicated in the supplement to the staff paper. The determined continuation of adjustment measures after the expiration of the present stand-by arrangement would be important to assure donors and creditors that a continued flow of external assistance would be used effectively.

Mr. Alhaimus stated that he was in broad agreement with the staff appraisal of Mauritania's adjustment program for 1985 and supported the proposed decision.

Mauritania had faced a difficult economic and financial situation in recent years, as manifested by depressed economic activity and relatively large domestic and external imbalances, Mr. Alhaimus remarked. The factors contributing to the present deep-seated difficulties had included the protracted drought in conjunction with desertification and the deterioration of the terms of trade, which in turn had contributed to the heavy external borrowing and inappropriate domestic policy responses. Against that background, the intensification of the authorities' adjustment efforts in the context of a comprehensive adjustment program for 1985 was encouraging. The formulation of that program within a medium-term framework and the emphasis placed on supply-oriented measures were particularly important in view of the structural nature of Mauritania's difficulties.

The measures undertaken in exchange rate policy were consistent with the program's emphasis on supply-side and external adjustments, Mr. Alhaimus continued. A competitive exchange rate had been restored by a significant depreciation and would be maintained by the adoption of a flexible exchange rate policy. In addition, all broken cross rates had been eliminated. A significant aspect of those measures was the full passthrough of their effects on prices, which would promote export and import-competing sectors and help to contain demand pressures on imports. That and other measures envisaged under the program should facilitate the achievement of the targeted sizable improvements in the external accounts.

The fiscal measures introduced were in line with the authorities' efforts to reduce expenditures and raise revenues aimed at eliminating budgetary imbalances, Mr. Alhaimus went on. On the expenditure side, the size of the civil service had been frozen, and salaries would continue to fall in real terms. In addition, government investment would be reduced by 44 percent. On the revenue side, measures had been taken to improve tax administration, broaden the tax base, and increase tax rates. It was noteworthy that the combined effects of those measures would generate a current budget surplus and reduce the overall deficit on a commitment basis by more than half as a percentage of GDP and that no increase in net bank credit to the Government would be allowed under the program.

The restrictive stance of monetary policy under the program was designed to contribute further to compressing aggregate demand, Mr. Alhaimus commented. Accordingly, credit expansion was limited to 5 percent and would be extended exclusively to the nongovernment sector. In addition, the interest rate structure had been raised in line with the underlying inflation rate. Further improvements in financial inter-ediation were also expected once a related study financed by the Arab Monetary Fund was completed.

The current program recognized the need to tackle structural difficulties in order to resume economic growth on a sustainable basis, Mr. Alhaimus observed. Continued efforts to rehabilitate the public enterprise sector were of particular importance in view of that sector's significant role in the economy and its cost to the budget. The authorities were cooperating closely with the World Bank and other donors to accelerate the implementation of that reform and to widen its scope. The World Bank had also endorsed the authorities' public investment program, which entailed a gradual reduction of outlays and emphasized projects that were consistent with the country's development needs.

Finally, like Mr. de Maulde, he was concerned about the level of Fund support, Mr. Alhaimus remarked. In that connection, it would be useful to know from the staff whether a compensatory financing purchase was being considered in view of the apparent shortfall in Mauritania's exports during 1984. It would also have been helpful if the staff had provided an explanation of the level of access granted under the present stand-by arrangement, which amounted to about 35 percent of quota.

Mr. Abdallah supported Mauritania's request for a stand-by arrangement. The value of the arrangement lay not so much in the amount being provided--SDR 12 million over 12 months was quite modest relative to Mauritania's financing needs--as in the assurance to other creditor and donor countries that the Mauritanian authorities were indeed serious in their efforts to stabilize the economy. In that respect, he noted with satisfaction that the meeting of creditors and donors held in March under the auspices of the World Bank had been successful in mobilizing the resources needed to close the financing gap of nearly SDR 200 million in Mauritania's balance of payments for 1985. The authorities and donors should work closely to ensure that disbursements were made in a timely manner, since the program under the stand-by arrangement left little room for maneuver.

Mauritania's economic situation was difficult and had been aggravated by the continuing drought, Mr. Abdallah observed. The magnitude of the problem could be gauged by the weak financial position of the public sector, the large accumulation of external and domestic arrears, and the general slowdown in economic activity. The narrow base of the export sector--with fish and iron ore accounting for the bulk of export earnings--left the country in a precarious position. Those basic facts emphasized that achievement of a viable economic situation in Mauritania would require a sustained adjustment effort over the longer term, and would not be accomplished through a one-year or two-year program. Structural change and economic diversification were urgently needed, and he was encouraged by the indication in the staff report that the authorities were thinking along those lines.

It was clear that the policy measures under the program were wide ranging, touching virtually all aspects of the economy, Mr. Abdallah remarked. Efforts to improve the performance of public corporations and reduce the fiscal deficit, and the decision to adopt a flexible approach to exchange rate management, represented steps in the right direction. He was, however, concerned that the program targets might be too ambitious. For example, the program called for widespread price increases as well as a 16 percent devaluation, yet projected an inflation rate of about 12 percent in 1985. Moreover, the current account deficit of the balance of payments was projected to drop sharply from the equivalent of 38.5 percent of GDP to 14.1 percent of GDP. In view of the country's narrow export base, slippages in projected export earnings might occur if either the estimated prices or the estimated volume of exports, or both, were not realized. Moreover, the 3 percent growth rate projected for the program period might not be fully consistent with the austerity measures being introduced. In that connection, he invited the staff to comment on the elements that were expected to contribute to economic recovery in 1985. He would also like to know the extent to which the sharp cutback in public investment was likely to be picked up by the private sector, which was to receive all credit expansion--amounting to 5 percent--permitted under the program.

Mr. Clark said that he welcomed the adjustment efforts already made by Mauritania and supported the proposed stand-by arrangement.

Nevertheless, Mr. Clark remarked, he had two concerns. First, he would appreciate any further information that the staff could provide on what was incorporated in the figures in the financing arrangements and on the firmness of the various commitments that had been made. The second concern related to the medium-term outlook and Mauritania's heavy dependence on export revenues from just two commodities: was it realistic to expect the kind of steady, sustained increase in iron ore prices and indeed in total export revenues that the staff had incorporated in the medium-term scenario? Debt and debt service levels remained extremely high, and Mauritania would remain vulnerable in respect of financing arrangements well into the future. Clearly, concessional finance must play the major role in support of the country's adjustment effort because Fund assistance would be inappropriately expensive; for that reason alone, the Fund's financial role in Mauritania should be limited.

Mr. de la Herrân said that he supported the proposed decision. It was clear from the staff paper that Mauritania faced a difficult external situation and that the authorities were making great efforts to cope with the major imbalances. He noted with satisfaction that the balance of payments financing gap for 1985 was nearly covered; thanks to an agreement reached at a meeting of donors and creditors in Paris in March, which had been chaired by the World Bank, commitments and indications of commitments for 92 percent of the financing needed had already been pledged.

He welcomed the 16 percent devaluation of the ouguiya, Mr. de la Herrân continued; it would be a positive factor in attaining a more viable trade balance. He also welcomed the authorities' intention to eliminate arrears by the end of 1985. In that regard, the Central Bank should obtain reliable information on nongovernmental external commercial credit and arrears as soon as possible. For that purpose, any technical assistance, such as that provided by the Arab Monetary Fund, would be helpful. Other measures, including the avoidance of new concessional loans and a decision to use new deposits to create a more solid reserve base, should also help in the implementation of prudent debt management policies.

The measures being undertaken to improve the management of the public enterprises, including the planned increase in charges and rates--which would establish a more realistic pricing policy in line with the exchange rate devaluation--were fully appropriate, Mr. de la Herrân added. The decision to reduce public investment expenditure gradually in order to alleviate the current unsustainable fiscal deficit was likewise a step in the right direction. In that regard, the submission of the authorities' investment strategies and projects to the surveillance of a consultative group was advisable. Nevertheless, the possibility of a shortfall of financing in the course of the 1985 public investment program was worrisome; the authorities should carefully calculate the financial resources available in order to avoid stop-and-go movements in that program.

The tightness of fiscal policy under the program appeared to be the only way to correct the unsustainable current position of the public sector deficit, Mr. de la Herrân commented. The cuts in current expenditures as well as the downward trend of public wages were in line with the recommendations made during the Board's discussion of the 1984 Article IV consultation. In addition, tax reform should be considered an essential tool of fiscal policy, not only to increase public receipts but also to achieve the wider target of strengthening tax administration.

As to monetary policy, Mr. de la Herrán remarked, he welcomed the measures to limit the expansion of total credit and to make it available only to nongovernmental sectors. Strict rules governing the external commitments of commercial banks should be maintained, as the debt situation was delicate and all measures to avoid the accumulation of doubtful credit were to be welcomed.

Mr. Salehkhou recalled that, during the discussion of the latest Article IV consultation for Mauritania in December 1984, he had stressed that the continuation of harsh environmental conditions and heavy foreign borrowing were leading to serious imbalances in the Mauritanian economy, and he had advocated urgent action by the Fund and the World Bank to help return the economy to a more favorable course. He was therefore particularly gratified that Mauritania's adjustment program for 1985 was being supported by both the Fund and the Bank. Considering its serious social impact, the program should, in his view, be extended over a number of years if it were to achieve the necessary results; recent events elsewhere had shown the dangers of abruptly introducing adjustment measures on a weak economic base.

Although the requested stand-by arrangement was for one year, the economic program formulated by the Government had been conceived in a medium-term context and aimed at achieving a sustainable balance of payments position by the end of the 1980s, Mr. Salehkhou observed. In support of that program, Mauritania was to be granted the use of Fund resources to the extent of only 35.4 percent of quota. He shared Mr. de Maulde's concern about such limited access. Considering Mauritania's outstanding obligations to the Fund in 1985, he wondered whether the stand-by arrangement should not be considered a partial rescheduling operation integrated with an adjustment program with the Fund.

The imbalances in the Mauritanian economy over the past few years, and particularly during 1984, had mainly been due to factors outside the country's control, Mr. Salehkhou considered, as was clearly illustrated by the sharp drop in cereal production--from 120,000 metric tons some twenty years previously to about 20,000 metric tons in 1983/84--owing to a decline in the average annual rainfall over a ten-year period, which had decreased the cultivable land area from 50 percent to 10 percent. To provide for essential imports, the Government had resorted to foreign borrowing, which had led to an unmanageable debt service burden and the accumulation of external payments. Despite a heavy reduction in government expenditures and investment programs as well as an improvement in the revenue base, a financing gap of SDR 197 million remained to be filled for 1985.

While the Paris meeting of Mauritania's main donors and creditors held in March 1985 to consider the financing gap seemed to have led to some progress, the second meeting scheduled for the end of April to examine debt servicing would have to provide Mauritania with generous concessional financing if the country were to cope with debt servicing in the years to come, Mr. Salehkhou commented. In that respect, the Fund could play a positive role, particularly in view of Mauritania's cooperation with the Fund and the Bank, the courageous steps that the authorities had undertaken to implement the adjustment program, and their resolve to meet the performance criteria throughout the rest of 1985.

The success of any program, Mr. Salehkhou remarked, could be measured only by the level of real economic growth, as reflected in the improvement of per capita income. He was concerned that the measures introduced to reduce investment by 44 percent in 1985 would necessarily limit the growth potential of the economy in favor of external adjustment targets. He therefore hoped to see some improvements in the overall economic picture at the time of the July review. In concluding, he supported the proposed decision.

Mr. Wijnholds said that he supported Mauritania's request for a stand-by arrangement and considered the amount of the arrangement appropriate under present circumstances. The program appeared to be a solid one and should--if implemented successfully--help to improve the economic situation of Mauritania considerably. He welcomed the elimination of external arrears that was envisaged and hoped that the authorities would be able to avoid incurring arrears in the future. Considering the high ratio of debt to exports and the debt service ratio projections provided by the staff, that would not be an easy task.

Creditor countries had shown an understanding of Mauritania's situation and were providing considerable resources to fill the estimated financing gap, Mr. Wijnholds commented. He hoped that the combination of financing and adjustment would enable Mauritania to avoid the difficulties that some other African countries were facing in meeting their financial obligations to the Fund.

Mr. Wang stated that he supported Mauritania's request for a stand-by arrangement. He also wondered whether the staff could give further consideration to the proposed amount of Fund assistance.

The staff representative from the African Department remarked that the program projected an economic growth rate of 3 percent for 1985 following a decline of almost 4 percent in 1984, owing in part to the drought and in part to certain economic policies. The key assumptions underlying the recovery were that more normal weather conditions would return in 1985 and that there would be an increase of about 15 percent in activity in the fishing sector following the resolution of the problems that had arisen with two major fish exporting partners in 1984. Furthermore, while public investment in 1985 was to be reduced by about 43 percent, to ensure that public investment would be more in line with the absorptive capacity of the economy and the available financial resources, the design of the public investment program for 1985 emphasized rehabilitation and quick-yielding projects in the agricultural sector that would have a more direct impact on increasing economic activity. That emphasis contrasted sharply with the design of the large public investment programs undertaken in the past that had emphasized mainly large infrastructural projects, which did not contribute directly to the productive capacity of the economy. Thus, the assumption of a growth rate of 3 percent was probably a conservative one, considering the decline in economic activity in 1984 and the emphasis being given to a more realistic public investment program in 1985, the liberalization of pricing policies, and exchange rate flexibility. Nonetheless, weather conditions could alter significantly the perspective for economic growth.

Rates of inflation of 8 percent and 4 percent had been recorded in 1984 and 1983, respectively, the staff representative noted. The targeted rate of inflation in 1985--at 12 percent--was higher, as it took into account the liberalization of pricing and marketing policies together with the exchange rate action, as well as the tight fiscal and credit policies. Thus, the projected rate of inflation was consonant with the overall package of measures included in the program.

The commitments and indications of assistance to cover the balance of payments financing gap amounted to $182 million, including a cash grant by Saudi Arabia, various multilateral loans by the Fund, the Arab Monetary Fund, and the Islamic Development Bank, and estimated debt relief for which rescheduling had already been secured or was expected, the staff representative explained. Additional commodity assistance had already been either confirmed, or promised. The Paris Club was to consider rescheduling $46 million; although the rescheduling was still pending, several countries had already indicated their willingness to reschedule Mauritania's debt service obligations in the context of the Paris Club. Negotiations with two countries were being conducted in an attempt to secure debt relief on outstanding debt service arrears for 1985 amounting to about $12 million. Moreover, the Arab Fund for Social and Economic Development had indicated its willingness to assist the authorities in a study of an emergency import project that would allow them to finance imports already included in the balance of payments projections.

As to the tightness of fiscal policy under the stand-by arrangement, the staff representative commented, the overall deficit on a commitment basis was to be more than halved from about 9 percent of GDP in 1984 to 4 percent of GDP in 1985. Although that was to be achieved partly through a reduction in the public investment program, the balance between domestic revenue and current expenditure was also to shift from a deficit of about 1 percent of GDP in 1984 to a surplus of about 1 percent in 1985, through both revenue-generating and expenditure-containing measures.

Interest rates had been raised by about 2 percentage points, and deposit rates were in the range of 7 percent to 11 percent, the staff representative noted. Rates on rediscountable loans were in the range of 8.5 percent to 12 percent, and those on nonrediscountable loans were in the range of 12 percent to 16 percent. These interest rates needed to be viewed relative to the average annual rate of inflation of 7 percent recorded in the past three years. However, even if the inflation rate of 12 percent projected for 1985 were realized, the bulk of the loans were nonrediscountable at interest rates ranging from 12 percent to 16 percent, so that the interest rate structure would remain generally positive in real terms. The program did, however, provide for discussion of the interest rate structure at the time of the midterm review. Moreover, the staff understood that the study for the reform of the banking system financed by the Arab Monetary Fund would aim at identifying its problems and suggesting ways and means of improving its operations.

As to pricing and marketing policies, the staff representative remarked, the wholesale price of sorghum, maize, and wheat had been increased by about 50 percent under the program, and parity with import prices was gradually being achieved for food received as grants; full import parity was to be achieved by 1987. A study being prepared by the authorities would determine how to liberalize the prices of certain basic commodities and how to handle those imported commodities for which a profit margin was set by the Government, taking into account the role played by certain public enterprises in the marketing system. The study was expected to be completed before the midterm review. Consideration was being given to moving toward a freely determined market system or widening the profit margins allowed for imports, or both.

The Government had indicated its determination to carry out a comprehensive reform of the public enterprise sector, the staff representative continued, and had initiated measures late in 1983 in close collaboration with the World Bank and other donors and creditors. As a result, the position of several enterprises had already improved; at the end of February, further negotiations with the World Bank had been concluded regarding measures to be implemented in the course of 1985, which had been detailed in the staff paper.

The public investment program for 1985 had been devised in close collaboration with the World Bank, the staff representative remarked, and emphasized projects that would contribute directly to economic growth and would reduce external borrowing. The program for 1985 showed a marked shift in financing, with about 32 percent of the program to be financed from grants, compared with about 19 percent in 1984.

The medium-term scenario envisaged a reduction in the current account deficit from about 14 percent in 1985 to about 5 percent in 1990, the staff representative observed. The overall balance of payments deficit was expected to be reduced from about SDR 72 million in 1985 and to achieve a small surplus by 1990. Nevertheless, declining financing gaps were expected to remain, which would require exceptional financing. With regard to new loans, the staff had assumed an average interest rate of 4 percent, a 5-year grace period, and 16-year maturity; clearly, the exact size of those gaps would depend on the debt rescheduling terms that were eventually established. Total interest payments would increase only marginally because the increase in interest payments on new loans was offset by declining interest payments on loans contracted prior to the end of 1984, reflecting a decline in outstanding loans.

As to capital inflows, the staff representative noted, the measures being taken by the authorities to liberalize pricing policies, increase domestic interest rates, and eliminate the overvaluation of the currency should contribute to increased capital flows to the extent that Mauritania could attract foreign investment. It was, however, difficult to determine the extent to which those measures would promote a major change in capital flows.

In 1983, the total fish catch had been about 300,000 tons; it was estimated to have declined to about 250,000 tons in 1984, mainly as a result of the dispute with two main fish exporting partners, the staff representative remarked. Nevertheless, those figures had represented a sizable expansion in exports of fish compared with 1979, when only 15,000 tons had been exported. Although it was difficult to determine the extent of the illegal fish catch, the exchange rate measures that had been taken should increase the profitability of the fishing sector by encouraging greater involvement by the private sector and reducing the incentives for smuggling. Furthermore, the authorities had created a new fish marketing agency, which was expected to increase recorded fish exports.

The projection of a 7 percent increase in iron ore prices in the medium-term scenario, the staff representative commented, was based on estimates and forecasts made by the World Bank as part of an industrial and mining project that it was undertaking in Mauritania. Moreover, the projection reflected the country's geographical position as well as the markets in which it traditionally sold its iron ore. Nonetheless, the projections were sensitive to differing assumptions regarding iron ore prices. For instance, an annual increase 2 percentage points lower than expected would delay the achievement of the balance of payments surplus by one year.

The authorities had not requested a compensatory financing purchase, the staff representative remarked. Moreover, the data for exports for 1984 presented in the staff report were estimated; if a compensatory financing request were forthcoming, fairly detailed data would need to be collected, and a determination would have to be made whether a shortfall existed and whether the causes for the shortfall were beyond the authorities' control.

As to the level of access, the staff representative from the African Department noted, the medium-term projections showed the need for a sustained adjustment effort to achieve balance of payments viability by 1990, with large but narrowing financing gaps remaining throughout that period. Thus, the Fund was expected to be involved in Mauritania for a number of years, and the amount of access was in line with the guidelines calling for the Fund to play a catalytic role.

The staff representative from the Exchange and Trade Relations Department explained that in proposing an amount of access equivalent to 35 percent of Mauritania's quota, the staff had been guided by the criteria established in EBS/83/233 (10/31/83) for situations where the Fund's role was to be primarily that of a catalyst:

> In some of these cases the debt service problem may be due in part to the large outstanding use of the Fund['s resources] by the member and further substantial purchases from the Fund would only aggravate the difficulties. In other cases, a substantial improvement in the balance of payments may call for fundamental economic changes which cannot be achieved within a medium-term time frame. In all these situations, Fund financing on a limited scale is justified if the member is taking appropriate steps to deal with its situation and such support will maintain the confidence of other creditors. The great bulk of the external financing must normally be provided on appropriate terms from sources other than the Fund.

The Fund could certainly be expected to be involved in Mauritania for a number of years. The country's debt service burden was already high, and the balance of payments scenario showed that exceptional financing on generous terms would be required even if the member were making determined adjustment efforts. Noting Mr. de Maulde's calculation of a net resource transfer to the Fund--as a result of adding charges to the repurchases falling due--he observed that the level of charges was not, and could not properly be, an element in considering the amount of access. Mauritania's outstanding use of Fund resources in the credit tranche would be essentially flat during the stand-by arrangement, not an unusual situation. For all those reasons, the staff considered that Mauritania fitted perfectly the criterion for access in cases where the Fund played primarily a catalytic role.

The staff representative from the World Bank agreed with Mr. de Maulde that Mauritania's fisheries provided an important opportunity to increase its gross domestic product. Nonetheless, they were being heavily fished by foreign fleets, only some of which were being properly controlled by the Mauritanian authorities. The major objectives of Mauritania's fisheries policy were to obtain greater control over and to increase its participation in fishing activities in its waters, and to develop shore facilities to service the fishing fleets. The French Government was providing technical assistance to help the authorities to improve their planning in the fisheries sector. The World Bank had undertaken a preliminary sector survey, which had been submitted to the authorities. Its principal recommendation was that a more comprehensive and coherent elaboration of the current strategy for fisheries be attempted with technical assistance; the Bank had offered one of its own experts. Although many donors were interested in contributing to projects in the fisheries sector, the framework in which to develop and operate them was lacking. One of the problems in the past had been that donors had invested in the sector, by financing equipment and infrastructure, which had not been properly used, and the debt service on those investments had contributed to Mauritania's economic difficulties. A first step in designing a well-conceived investment program in the fisheries sector would be to develop a coherent fisheries policy with technical assistance, and then to call a special meeting of interested donors later in 1985.

Mr. Alfidja remarked that a major constraint to effective project implementation in Mauritania was the acute shortage of skilled and well-trained manpower. The authorities were conducting a review of ways to overcome that constraint; if they could do so, a growth rate of 3 percent could certainly be attained and perhaps even exceeded.

A request by Mauritania for use of Fund resources under the compensatory financing facility was not excluded, Mr. Alfidja commented, although the authorities would have to supply the necessary data before the Fund could process the request. As to the level of access under the stand-by arrangement, Mauritania and many other countries in his constituency considered that a balance had to found between purchases and repurchases. Nevertheless, they were concerned that, if the Fund were to decrease substantially their level of access at present, it might not be possible for them to mobilize the necessary additional financing from other sources.

The Executive Board then took the following decision:

1. The Government of Mauritania has requested a stand-by arrangement for a period of 12 months from April 12, 1985 for an amount equivalent to SDR 12 million.

2. The Fund approves the stand-by arrangement as set forth in EBS/85/41, Supplement 2.

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

Decision No. 7950-(85/58), adopted
April 12, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/57 (4/10/85) and EBM/85/58 (4/12/85).

3. BOLIVIA - TECHNICAL ASSISTANCE

In response to a request from the Bolivian authorities for technical assistance in the preparation of the 1985 government budget, the Executive Board approves the proposal set forth in EBD/85/93 (4/5/85).

Adopted April 10, 1985

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/110 and 84/111 are approved. (EBD/85/92, 4/5/85)

Adopted April 11, 1985

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/93 (4/9/85) and EBAP/85/95 (4/10/85) is approved.

APPROVED: February 5, 1986

LEO VAN HOUTVEN
Secretary