

MASTER FILES

ROOM C-120

04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/72

10:00 a.m., May 8, 1985

J. de Larosière, Chairman

Executive Directors

Alternate Executive Directors

L. K. Doe
A. R. Ismael, Temporary
E. L. Walker, Temporary
H. G. Schneider
G. E. L. Nguyen, Temporary
M. B. Chatah, Temporary
M. Sugita
D. Hammann, Temporary
Z. b. Ismail, Temporary
G. W. K. Pickering, Temporary
J. Hospedales, Temporary
A. K. Juusela, Temporary
A. Abdallah
M. A. Weitz, Temporary
E. M. Taha, Temporary
J. E. Rodríguez, Temporary
A. A. Scholten, Temporary

C. R. Rye

O. Kabbaj
A. S. Jayawardena
T. A. Clark
N. Coumbis

Zhang Z.

L. Van Houtven, Secretary
B. J. Owen, Assistant

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Also Present

B. Sunzu, Embassy of Burundi. IBRD: D. J. Pratt, Eastern and Southern Africa Regional Office. African Department: R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director; A. I. Abdi, J. Artus, A. Basu, S. E. Cronquist, G. Devaux, I. A. H. Diogo, P. J. Duran, A. G. A. Faria, Y. Fassassi, M. G. Fiator, M. Sidibé. European Department: D. A. Brodsky. Exchange and Trade Relations Department: S. Kanesa-Thasan, M. O. Tyler. Legal Department: Ph. Lachman, J. K. Oh. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, S. M. Hassan, H.-S. Lee, J.-C. Obame, A. Vasudevan. Assistants to Executive Directors: G. Biron, R. Fox, H. Kobayashi, S. Kolb, W. K. Parmena.

1. BURUNDI - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Burundi, together with a proposed decision concluding the 1985 Article XIV consultation (SM/85/111, 4/17/85). They also had before them a report on recent economic developments in Burundi (SM/85/117, 4/26/85).

Mr. Bernard Sunzu, Counsellor at the Embassy of Burundi in Washington, was also present.

The staff representative from the African Department noted that in the last line of Table 20 in SM/85/117, the percentages given for rediscounted credit out of total credit should be corrected to read 6.4 percent for 1980, 26 percent for 1981, and 20.6 percent for 1982, in line with the figures used in the text. In addition, on pages 67 and 68 of SM/85/117, the references to the relationship between gross official reserves and imports should be corrected in each case to refer to 33 weeks in 1980, 9 weeks in 1982, and 7 weeks in 1984, respectively, rather than to the same number of months.

Mr. Abdallah made the following statement:

Burundi's economic performance in 1984 reflected an interplay of two sets of forces: the first was a combination of a severe drought, which had reduced food production by 10 percent and coffee production by 27 percent, and a sharp curtailment of capital inflows which had depressed the economy and forced the country for the first time to look for external food aid. Second, sharp improvements in agricultural productivity in the case of cash crops and considerable restraint in fiscal and monetary policies had worked in the direction of restoring equilibrium. The impact of the drought on the agricultural sector was transmitted to the manufacturing sector which was basically geared to processing, leading to a fall in GDP by 4.1 percent in contrast with a growth of 1.1 percent in 1983. Despite restrained fiscal and monetary policies, the rate of inflation accelerated to 14 percent in 1984 from about 8 percent in 1983, reflecting the impact of higher food prices and the 23 percent devaluation of the Burundi franc in November 1983.

It is a long-standing government policy in agriculture to maintain food sufficiency and to promote diversification in order to lessen reliance on coffee while raising the relative shares of cotton, tea, tobacco, wheat, rice, and fruits and vegetables through adequate incentives, including the provision of inputs and extension services. In 1984, there were signs of success with a remarkable improvement in the quality of coffee and tea resulting in higher unit export value; there was also increased production of fruits and vegetables as a result of

government encouragement and a relative shift from the cultivation of maize to rice which has a higher yield per hectare. Nevertheless, the authorities agreed with the staff on the need to continue maintaining adequate incentives to producers and they have therefore started to re-examine the ex ante formula (échelle mobile) for the distribution of coffee receipts between production, processing, transportation, and the stabilization fund.

The performance of public enterprises has continued to be mixed and since the authorities do not have any particular ideological attachment to these enterprises, they are working out a technical assistance program with the World Bank for the rehabilitation of some of them. The authorities are also prepared to turn over a number of them to the private sector.

In the field of fiscal policy, Burundi in 1984 combined restraint on current expenditure with a lower level of capital spending mainly due to the completion of externally financed projects in 1983 with considerably increased revenues to reduce the budgetary deficit from 15 percent of GDP in 1983 to 8 percent. The authorities continued to hold down wages and salaries which had remained frozen for the last five years. On the revenue side, the application of the échelle mobile formula, the higher coffee prices, and the devaluation in November 1983 led to a 24 percent increase in total revenues and grants in 1984. In 1985 the budgetary deficit is expected to show some increase because of the need to pay arrears on contributions of employees to the Social Security Fund, higher interest payments on public debt, and substantial increases in foreign-financed capital outlays. To contain the impact of these increases, the authorities are continuing with their policy of wage and salary restraint and are not recruiting new personnel. They are also phasing out a substantial amount of subsidies and transfers to public enterprises. A number of discretionary tax measures have also been taken and the authorities are evaluating the recommendations of the technical assistance mission from the Fiscal Affairs Department in a positive frame of mind. With a tax to monetized GDP ratio of 24-27 percent, Burundi has maintained a very high tax effort relative to most countries at a similar level of development.

In 1984 the Government sharply curtailed its resort to bank financing to FBu 1.7 billion from FBu 2.85 billion in 1983 and rather than accumulate any arrears, paid off FBu 1.08 billion of claims against it. Since domestic credit in Burundi reflects mainly developments in budgetary deficit financing and movements in coffee exports and stocks, monetary policy in 1984 was sharply restrained. Overall domestic credit expanded by only 2.7 percent in sharp contrast with 18.1 percent in 1983. The small expansion was entirely due to the public sector as the expanded coffee crop

was financed from nonbank domestic sources. The slowdown in domestic credit together with a 10 percent contraction in net foreign assets led to a 3.2 percent increase in broad money in 1984 (against a nominal increase in GDP of 11.3 percent). Although there has been little credit expansion to the noncoffee productive private sector, this has been more the result of the low priority accorded by the banking sector to the financing of high risk activities rather than to the Government's crowding out these sectors. However, the authorities have been concerned by recent credit developments and would like to see the private sector play a more balanced and active role and are therefore looking closely at the management of monetary policy in the background of the prevailing institutional environment, including the discounting system, with technical assistance from the Fund. They also intend to review their interest rate policies and to carefully evaluate the effect of interest rates on the mobilization of internal and external resources. While the authorities are committed to raising interest rates from their present low real levels they also want to see the extent to which they can rein in inflationary pressures before they settle on the appropriate interest levels.

A measure of success has been achieved in arresting the deterioration of the external sector. The 23 percent depreciation of the Burundi currency in November 1983 and contractionary fiscal and monetary policy which were undertaken in 1984, together with the increase in coffee export earnings, helped to bring down the current account deficit to SDR 64.2 million from SDR 86.7 million in 1983. Nonetheless, a sharp reversal on the capital account brought about by the completion of major projects in 1983 and the slower rate of implementation of the new Five-Year Plan (1983-87) projects led to a sharp cutback in capital inflows and a return to an overall balance of payments deficit in 1984 from a moderate surplus recorded in 1983. The authorities remain flexible in their exchange rate policy as indicated in the adjustment of their exchange rate in November 1983. They agree that their exchange rate has appreciated toward the end of 1984 because of the rapid rate of internal inflation but they believe that with a return to more normal weather conditions, the inflationary pressures would ease, and the exchange rate situation can then be reviewed. The authorities' view is that the restrictions on current payments and transfers are temporary and were necessitated by the growing balance of payments difficulties, particularly in view of the limited scope they have for using tariffs to reduce imports because of their membership in the Preferential Trade Area. They intend to review the situation as soon as the balance of payments situation permits. They are also aware of the increasing debt burden and intend to be very cautious in resorting to external borrowing in the future.

It is clear from Table 2 of the staff report, containing balance of payments projections for 1985-89, that Burundi is likely to face serious payments problems over the medium term and that urgent corrective measures need to be taken. On page 17 the staff urges the authorities to implement a "comprehensive and effective adjustment program that adequately restrains aggregate demand, addresses the issue of relative pricing, strengthens competitiveness and effects other structural changes to improve production possibilities over the medium term." Yet the same paragraph appears to leave the task of assisting Burundi toward achieving internal and external balance almost entirely to the World Bank with which "preliminary discussions on a possible SAL program" are under way. At the same time the staff report that "the authorities have also recently renewed their request for possible use of Fund resources."

It is imperative that the Fund become involved in extending necessary assistance to Burundi for several reasons. First, Burundi has a very good track record with the Fund as it has no arrears and the only credit it enjoys is from Trust Fund resources. Second, despite the recent slippages in performance, the country's overall economic record has been good and the country has no external arrears. Third, Burundi is among the least developed countries with a per capita income of about \$200. Fourth, Burundi is mountainous and one of the most densely populated countries in Africa with over 165 inhabitants per square kilometer. Fifth, Burundi is completely landlocked and its nearest port, using both lake and rail transport, is Dar es Salaam in Tanzania, 1,430 kilometers away. Road transport is mostly via the northern route through Rwanda, Uganda, and Kenya that is 2,025 kilometers long. Geography alone, therefore, raises Burundi's transport costs by at least 30 percent. Sixth, because of its geographical situation Burundi feels a need to maintain sizable stocks of all essential supplies and is also forced to maintain large stocks of its exports. The 1984 drought merely compounded the immutable adverse factors.

In recognition of the special circumstances facing Burundi, the donor community has been most sympathetic and helpful to it and the other countries in similar situations. It is imperative, therefore, that the Fund should also be responsive. The medium-term projections in Table 2 are based on the existing exchange rate which is currently under review by the authorities. There is no doubt that calculations made on a realistic exchange rate which will be administered in a flexible manner, will show a different picture not only on the current account but also on the capital account, particularly the item covering "errors and omissions."

In the light of the above considerations, I would urge Executive Directors to show greater sympathy to the circumstances of Burundi and to create conditions which facilitate successful negotiations with the Fund.

Mr. Schneider stated that the economy of Burundi provided a typical example of the difficulties faced in the present changing economic environment by primary producer countries that were at the mercy of climatic conditions. The economic performance of such countries was dictated by changes in the demand for their main domestic products and by the lags with which they adjusted domestic policy to external factors. The limited size of Burundi's domestic market was an additional obstacle to a quick reaction to economic incentives, and being landlocked, Burundi also lacked access to world transport facilities.

The staff had cogently appraised Burundi's current problems in its reports and highlighted the important and difficult choices the authorities would have to make to regain the sound economic situation that had prevailed until the beginning of the 1980s, Mr. Schneider continued. In general, he concurred with the staff analysis and would therefore comment only on some present trends that he believed must urgently be reversed. The authorities had already begun to implement some adjustment measures, for which they were to be commended; however, they must not relax their efforts in 1985.

The severe drought of 1984 had caused major setbacks in terms of real GDP, inflation, and the balance of payments deficit, Mr. Schneider remarked. In addition, the authorities' earlier decision to improve existing production systems and infrastructure by means of an ambitious investment program had increased the various imbalances. The expansion in fiscal expenditures and the limited saving capacity of the domestic private sector had required increased recourse to domestic bank financing and external borrowing, which in turn had worsened the medium-term prospects of the economy. The pursuit of adequate fiscal policies was central to the resolution of Burundi's current problems. The further development of the economy was in fact threatened by the inappropriateness of present fiscal policies, which had long been undermining the country's ability to mobilize resources to finance its development policies. The outlook for external debt was particularly worrisome, the foreign debt service burden being a major threat to Burundi's development prospects.

The budget planned for 1985 was hardly realistic since it would cause an additional deterioration of present imbalances, Mr. Schneider observed. The authorities' efforts during 1984 to cut the fiscal deficit by limiting such expenditures as public sector wages and capital outlays had already produced positive results, and those efforts must be continued in 1985. Owing to the limited availability of financial resources, further progress needed to be achieved in reducing transfers to public sector enterprises and cutting back the ambitious investment program.

Against that background, it was especially welcome that the authorities had decided to eliminate virtually all transfers and subsidies to public enterprises, starting in 1985, Mr. Schneider considered. A further step toward the rehabilitation of those enterprises could be taken with the aid of the World Bank, which could devise a structural adjustment loan program to help the authorities, who were determined to improve resource allocation in the manufacturing sector. Given the current level of external resources, the World Bank could also make its expertise available to assist the authorities in making difficult choices between infrastructure projects and projects more directly related to increasing productive capacity. The projects chosen must be those that would most rapidly correct the economic imbalances.

The desire of the authorities to improve revenue performance was also quite evident, Mr. Schneider noted. He hoped that they would lose no time in implementing the recommendations of the recent technical assistance mission from the Fiscal Affairs Department. They should be urged to make use of Fund technical assistance in adopting more efficient accounting and budgetary procedures. Other African countries that had done so had found that those procedures permitted better monitoring of public expenditures and revenues, helped to eliminate arrears, and thereby led to a sounder fiscal position.

Another crucial point was the need to adjust the domestic prices of factors of production and final products, taking into account the prevailing inflation rate, Mr. Schneider stated. The authorities had already acted on producer prices to encourage farmers to increase both the volume and the quality of export production. To keep pace with inflation and the exchange rate of the Burundi franc, that policy must continue to be actively pursued. The present plans to seek bilateral assistance in reviewing producer costs and prices in the coffee sector could be extended to other domestic industries, thereby strengthening productive sectors and leading to a greater diversification of the economy. Appropriate exchange rate and domestic financial policies were needed to improve resource allocation and to foster increased production for import substitution and exports.

The staff's views on exchange rate policy were appropriate, Mr. Schneider remarked. The correction of the appreciation of the Burundi franc since November 1983 and the adoption of a flexible exchange rate policy aimed at maintaining the country's competitiveness were two key measures that could quickly produce positive results and permit a return to a more liberal exchange and trade system. In addition, an appropriate interest rate policy that provided an adequate return on domestic savings would help to expand the monetized part of the economy and make it more efficient. The authorities seemed ready to implement such a policy with the Fund's support; if their readiness was confirmed, he hoped that an agreement on a program could be reached quickly with the main goals of implementing adequate fiscal, monetary, and exchange rate policies.

To conclude, Mr. Schneider urged the authorities to implement as soon as possible the measures that had already been defined as being necessary to restore a sound economy and to pursue further adjustment efforts with the aid and support of international institutions.

Mrs. Walker noted that Burundi's economic performance had improved during 1984 but the prospects for future improvements remained weak; clearly, a strong adjustment program was called for. The authorities seemed to be aware of the worrisome outlook for the economy and were considering technical assistance in several key areas from both the Fund and the World Bank to help them make some of the needed changes. The first step in any effort to implement the kind of adjustment program necessary to move the economy ahead was to revise the 1985 budget in a way that would continue the improvements recorded in the Government's fiscal position during 1984. In that respect, she urged the authorities to take care to select projects on which capital outlays were financed by foreign borrowing, choosing those aimed at diversification of the export sector and having a domestic-financed counterpart that could be met through budgetary savings and grants. Furthermore, she stressed the need for continued efforts to redress deficiencies in budgetary data and procedures.

Public sector enterprises played an important role in Burundi's economy but the sector was beset by a host of serious problems, Mrs. Walker noted. Fortunately, the authorities planned on phasing out current subsidies and transfers and limiting capital transfers to public sector industries. But to salvage the sector, it seemed imperative that the authorities implement complementary reforms with the help of the World Bank, to make it more attractive to the private sector to purchase industries currently in the public sector. Perhaps the staff could comment on other ways in which the Government might attract more private sector interest in traditional public sector enterprises, particularly in the manufacturing sector. Efforts to privatize some of those enterprises could naturally lead to growth in credit to the private sector, which had declined in recent years. The authorities' ongoing review of credit policy could examine the relationship between the availability of private sector credit and the role of the private sector in the economy.

As for supply policies, Mrs. Walker continued, she had been pleased to note the increase in cotton production and considered that the 17 per cent increase in producer prices had been a significant factor in that result, together with the financial and organizational reforms in the parastatal responsible for cotton. Her chair welcomed the intention of the authorities to diversify production away from the coffee sector through the use of more adequate price incentives to encourage export diversification. The efforts of the authorities to raise the quality of coffee in order to receive higher export prices as well as their intention to review producer prices in that sector were also welcome. She wondered whether it would be profitable for the authorities to continue to produce coffee in excess of their export quota and sell it at a discount or whether it would be more profitable for them to gear production of higher quality coffee more closely to the quota limits, diversifying activity into other export areas instead.

Without appropriate fiscal measures, the prospects for the external sector in the medium term appeared grim, Mrs. Walker observed. In spite of an improvement in the budget deficit in 1984, a substantial depreciation of the franc in 1983, and an intensification of import restrictions to curb demand, balance of payments pressure had persisted. The financing gap forecast for 1985 and beyond also implied a sizable increase in debt service payments. It seemed apparent that further measures must be taken to increase the possibility of a sustainable balance of payments position, including a more flexible exchange rate policy, producer pricing policies that would help to stimulate production--particularly with an eye toward export diversification--and fiscal measures that would improve the budgetary situation. Policies in those areas would also provide an opportunity to reduce restrictions in the trade and payment system.

Finally, Mrs. Walker said that she had noted from Mr. Abdallah's statement that the Burundi authorities were interested in exploring the possibility of a Fund program. She recalled that her chair had expressed sympathy with the authorities' interest at the time of the 1983 Article IV consultation and had hoped that they would adopt a comprehensive adjustment program justifying Fund financial support. Such a program did not yet appear to have been fully developed, yet it remained a crucial condition for dealing with the economic situation in Burundi and was an essential justification for the commitment of Fund resources, which could only be used to finance a temporary balance of payments need and not as a substitute for development assistance. Certainly, she recognized that Burundi's difficult economic circumstances had been caused largely by external factors, but continued to look to the authorities to take the needed steps, as outlined in the staff reports, to implement a sound adjustment program.

Mr. Scholten recalled that the 1984 Article IV consultation with Burundi had been characterized by the hope that a start had been made on a more forceful implementation of the needed adjustment policies, which had been underlined by the major exchange rate adjustment that had just taken place. Indeed, significant progress had been made in reducing the fiscal and current account deficits, notwithstanding the severe drought that had plagued the country. Unfortunately, the picture in the staff report for the 1985 Article IV consultation was one of slippages. Despite some commendable measures, the budgetary deficit was projected to rise again in 1985, from 8.5 to 10 percent of GDP, although the staff was urging its immediate reduction below 7 percent and its full elimination rapidly thereafter. If he was not mistaken, such an outcome would give rise to problems of its own, as the presence of substantial external financing would probably lead to a buildup of large government balances with the banking system. Furthermore, the depreciation of the currency at the end of 1983 was rapidly being undone as the exchange rate had not continued to be managed flexibly, even though the importance of continued flexibility had been emphasized in the summing up of the Executive Board's discussion of the 1983 Article IV consultation report (EBM/84/33; 2/29/84). It therefore came as no surprise that the tentative current account projection for 1985 also showed a larger deficit than in 1984.

Corrective fiscal and exchange rate policy measures were even more necessary than in 1984 to keep the imbalances within manageable proportions, which was fortunately still possible in Burundi, Mr. Scholten considered. Therefore, he fully endorsed the view that a comprehensive adjustment program should be urgently adopted along the lines set out in the staff appraisal. In inviting greater understanding of Burundi's situation, Mr. Abdallah had expressed the view that more Fund assistance was needed to help Burundi achieve internal and external balance, a task that he would regret seeing left entirely to the World Bank. He himself fully agreed with that view and considered that the staff report and the technical assistance already provided by the Fund went a long way in that direction. However, if the aim was financial assistance from the Fund, certain questions would have to be answered.

First of all, Mr. Scholten observed, Burundi had been fairly successful in attracting foreign loans on concessional terms, even in 1984. The staff had noted the need to reduce the level of investment, stating explicitly that the mere availability of foreign resources--even if obtained on concessional terms--should not determine the level of investment. Those and other statements in the staff report supported the view that Burundi's problem was more one of adjustment and of putting external resources to best use than one of financing per se and that any financing problem was more a matter of seeking very concessional terms. Therefore, he failed to see how Burundi's interests would be served by incurring the fairly heavy debt service burden that financial assistance from the Fund would impose. For the same reason, a structural adjustment loan on IBRD terms would be of doubtful benefit. However, it was not clear from the staff report whether such a loan would be extended on IDA terms, which would be quite appropriate.

Nevertheless, the adoption of a comprehensive program which in his view would be the most important justification for Fund assistance, could be useful in the interplay of forces between Burundi, the Fund, the World Bank, and bilateral donors.

Mr. A. R. Ismael observed that the 1984 drought had had quite an adverse effect on the economic performance of Burundi. Real GDP was estimated to have fallen by 4 percent, thus reducing per capita income further. Consumer prices, too, had risen significantly as a result of food shortages and the November 1983 devaluation of the Burundi franc. Yet the overall fiscal imbalance had narrowed in 1984; likewise, a small improvement was visible in the external situation, owing mainly to higher export earnings from coffee.

Referring first to the real sector of the economy, Mr. Ismael welcomed the authorities' intention to allow agricultural food crop prices to continue to be market determined. The effect of that policy, together with the supply of extension services and the availability of fertilizer, should increase the output of food crops and improve activity in the food processing industries, if the weather cooperated. As for cash crops, he joined Mrs. Walker in welcoming the payment of a premium for higher

quality coffee. Similarly, the decision to renovate the tea and cotton factories with a view to improving the quality of those products augured well. He encouraged the Burundi authorities to maintain and if possible expand those incentives in order to stimulate growth in the agricultural sector.

In the fiscal sector, he had noted the significant decrease in the overall fiscal deficit in 1984, an improvement reflecting the combination of a better revenue performance and a decrease in total expenditure, Mr. Ismael continued. The restrained wage and employment policy, together with the reduction in capital outlays, had contributed to the reduction in government spending. He had noted in particular that there had been no general wage increases since July 1980 although the consumer price index had risen cumulatively by more than 40 percent during the period from 1981 to 1984. By implication, there had been a sharp decrease in real purchasing power. The Government had also undertaken to settle some payments arrears. But despite those efforts, the fiscal situation remained weak, and he urged the authorities to continue to take steps to improve it. In that connection, the reinforcement of the authority of the Minister of Finance in controlling current expenditure and the accumulation of payments arrears was a step in the right direction. The decision of the authorities to eliminate all subsidies and transfers to the public enterprise sector was welcome, as was the start of discussions with the World Bank on the rehabilitation of that sector. As for capital expenditures, he welcomed the authorities' decision to implement only projects financed with concessional loans. However, he urged them to take steps to ensure that investment projects were carefully selected, in particular by paying due regard to economic criteria.

Concerning external debt, as the staff had pointed out, there was cause for concern at the high debt service ratio, which had more than doubled over the past two years and was projected to increase further in the medium term, Mr. Ismael noted. In light of the concessional nature of the loans and the strong limitations on the productive capacity of the country, he urged the authorities to take action aimed at avoiding a worsening of the debt profile.

Finally, Mr. Ismael welcomed the intention of the authorities to seek the assistance of the World Bank and the Fund in their attempt to solve their economic problems. Without denying the clear need for adjustment, he believed that sight should not be lost of the forbidding constraints confronting the economy; durable improvements that would not tear the economic and social fabric of the country would take time. He supported the proposed decision.

Mr. Jayawardena observed that Burundi was a small, landlocked country with a high population density and a per capita income of about SDR 240. Transport costs to the nearest export point reportedly added a third to the cost of tradable goods, a substantial handicap that must be a sobering thought to decision makers in their efforts to keep the domestic economy competitive. It was to the credit of the authorities that every effort

had been made to manage the economy prudently, as reflected in the relatively comfortable external position until recent times, despite a sharp worldwide recession. Apparently, the development strategy of the authorities was to undertake a substantial capital investment infrastructure program, funded partly externally and partly by a substantial domestic tax effort. No doubt the result had been some overheating of the economy, which had been reflected in a resurgence of inflation and a worsening of the balance of payments, in spite of an improvement in the terms of trade in 1984. The recent drought had once again exposed the continuing vulnerability of the economy. The medium-term prospects were somewhat worrisome, but he had been heartened by the declared commitment of the authorities to undertake with Fund assistance the necessary adjustment measures. Indeed, he encouraged them to act decisively and to approach the Fund soon.

The main issue was the flexibility of exchange rate policy, Mr. Jayawardena considered, which the authorities had apparently had some difficulties in maintaining since the welcome depreciation in 1983. He recalled the recent discussion in the Executive Board of another small economy--Trinidad and Tobago--in which some doubts had been expressed on the measurement and evaluation of real effective exchange rates, as indicated by such calculations in small economies, as well as on the pursuit of a fully flexible exchange rate policy. He wished to reiterate his view that the low elasticities evident in small economies--for instance, Burundi's major export, coffee, was subject to an international agreement--suggested that a major depreciation of the currency might be dissipated in a wage/cost spiral, with little or no gain to the country. In addition, small countries like Burundi should not, in determining their exchange rate policy, be chasing short-term fluctuations in domestic prices induced by drought and other seasonal factors; rather, they should take into consideration the longer-term prospects and expectations for domestic inflation by prudently managing the exchange rate to ensure competitiveness of the domestic economy. In taking that position, he was not condoning an exchange rate appreciation that was out of line with foreign currencies; rather, he was advocating cautious, measured exchange rate adjustments that were not vitiated by domestic wage/cost developments. There was no eternal wisdom in the field, but when the world's major currencies were clearly out of alignment, caution was essential.

Uncertainties relating to the exchange rate made improvements in domestic fiscal, monetary, and pricing policies crucial to the necessary adjustment process in Burundi, Mr. Jayawardena noted. He welcomed the reduction of the fiscal deficit, especially the domestic bank financing component, an area in which the main thrust of adjustment might have to be made, as the staff had noted. The recommendations of the technical assistance mission from the Fiscal Affairs Department deserved attention. Expenditure restraint was important, but it should not be achieved largely at the expense of critically important capital investment. A more productive area for making economies might be the parastatal sector, which was a cause of problems in many developing countries. Of course, it was not that easy to discipline the parastatal sector, in view of its

political clout, but a good start might be made by exposing public sector enterprises to the rigors of a competitive market and to less government subsidization.

Once fiscal policy was put on a sound footing, there might be far fewer monetary problems to deal with, Mr. Jayawardena commented. He had noted the staff's view that the interest rate on deposits should be made positive in real terms. Apparently, that rate was below the average inflation rate, but in an economy with such a low per capita income and with a population living at a subsistence level, savings might well not respond greatly even if the deposit rate became positive. The staff's recommendation seemed to be based more on conventional logic than on the behavioral realities of less developed economies. However, he could agree that deposit rates should be raised somewhat because the current gap between the deposit and lending rate was rather high.

Although real GDP had declined in 1984, due largely to a severe drought, Burundi's record of economic growth in the 1980s had been noteworthy, Mr. Jayawardena observed. As was evident from Appendix IV to the staff report, there had been positive growth in three out of five years in the 1980s; even in 1984, the level of real output had been higher than in 1980, and the output base seemed to have remained intact, despite natural disasters. Hence, he was inclined to believe that an adjustment program at the present time would result in positive gains, especially if it was designed to restrain demand as well as to encourage supply. It should be noted that the average rate of inflation, as measured by the GNP deflator in the five years ended 1984, had been less than 9 percent, which was low by international standards.

According to Mr. Abdallah's statement, the authorities wished to achieve self-sufficiency in food and to promote diversification of the economy, both of which were laudable objectives, Mr. Jayawardena went on. The authorities were cooperating with the Fund and Bank in matters of agricultural producer pricing. Even in regard to public enterprises, they were working out a technical assistance program with the World Bank for the rehabilitation of those enterprises and were ready to hand over a number of them to the private sector. As he had already said, if the difficulties of that sector were tackled, the major fiscal problems of Burundi would be largely solved. He also welcomed the authorities' intention to restrain current expenditures and to phase out subsidies and transfers.

Finally, Mr. Jayawardena noted, the authorities had renewed their request for use of Fund resources, although the staff had given no indication as to whether the request was presently being considered or whether it even would be considered. Mr. Abdallah had urged that the Fund should extend the necessary assistance to Burundi for several reasons, which in his own view were weighty ones. He had noted the staff's statement that "the authorities should take early action to implement a comprehensive and effective adjustment program that adequately restrains aggregate demand, addresses the issue of relative pricing, strengthens competitiveness, and

effects other structural changes, to improve production possibilities over the medium term." In his view, the salient words were "early action," which would ensure the success of an adjustment program supported by the Fund. The discussions with the authorities had led to an agreement to review most of their policy stances; he had not seen a single instance of disagreement between the staff and the authorities, whose attitude showed a clear sense of cooperation and accommodation on issues affecting the medium-term prospects of the economy. Thus, he strongly urged that a medium-term arrangement be devised, which would allow Burundi to make the necessary structural changes to increase production and improve the allocation of resources and competitiveness.

Mr. Nguyen said that he supported the proposed decision. He would be interested in hearing the staff's comments on the prospects for a Fund-supported program for Burundi.

The staff representative from the African Department commented that the private sector might have more of an incentive to become interested in taking over certain enterprises that were presently in the public sector if the review of the Investment Code being undertaken by the World Bank and the authorities could be completed quickly and appropriate amendments made. The restrictions currently applied to the transfer of profits, dividends, and earned income were, in fact, a disincentive to any private sector activity in Burundi. In considering how to amend the Investment Code, it might be worthwhile for the authorities to reconsider those restrictions. The review of the pricing system that was also being discussed by the authorities and the World Bank with a view to phasing out unnecessary controls might also lead eventually to greater private sector interest in certain public sector enterprises.

In the long run, it would be more useful if the authorities followed a policy of placing greater emphasis on improving the quality of coffee and of diversifying the productive base, the staff representative commented. A policy designed to increase coffee output required Burundi to place amounts in excess of its quota on nonquota markets at substantial discounts, an outlet that might not always be available.

The structural adjustment loan being discussed between the Burundi authorities and the World Bank, and the request by the authorities to be included among the countries eligible for financing from the Special Facility for sub-Saharan Africa, were likely to be extended on IDA terms, the staff representative remarked.

An appropriate exchange rate policy would help the noncoffee sector--mainly tea and cotton--but above all would help increase output for export in the manufacturing sector, the staff representative explained. Because Burundi was a member of the regional Preferential Trade Area (ZEP), the members of which intended to reduce customs duties with a view to their elimination within about 10 to 15 years, it would be at a disadvantage if the exchange rate did not allow the manufacturing sector to compete on the markets of the other member countries. Furthermore, an inappropriate

exchange rate policy would make it impossible for the authorities to finance through the budget their policy of maintaining remunerative producer prices for export crops. For all those reasons, the exchange rate as a tool of economic management had its part in the overall adjustment framework.

As for the possibility of Burundi making use of Fund resources, the staffs of the Fund and the World Bank were in touch with the Burundi authorities with a view to examining the appropriate steps to be taken to address the structural problems described in the staff report for the 1985 Article IV consultation, the staff representative from the African Department concluded, together with demand management policies that could be put in place without preventing economic growth.

Mr. Abdallah explained, in response to comments he had received prior to the commencement of the Board meeting, that he had referred in his opening statement to Burundi as being mountainous and one of the most densely populated countries in Africa simply to emphasize that topography and population limited the scope for influencing the production/supply response in Burundi more than it did in other countries.

Four years of negotiations, conducted under the auspices of the EC and UNCTAD, had culminated in a Regional Transit Agreement, which had recently been signed by the Governments of Burundi, Rwanda, Uganda, and Kenya, Mr. Abdallah stated. As a result, the flow of goods on the northern route between the three landlocked countries and the Port of Mombasa in Kenya would be faster and transport charges would be lower. The European Development Fund would bear the cost of facilitating the implementation of the Agreement. There was a strong expectation that Zaïre might join the Agreement before long in order to facilitate the movement of goods to and from its eastern region. The new arrangement would definitely promote efficiency within the four East African countries.

The performance of Burundi prior to 1984 had been good and in some respects better than that of many countries in Africa, Mr. Abdallah commented. The staff report before the Executive Board showed that in some years gross foreign reserves had covered 33 weeks of imports, a level not attained by many developing countries. Burundi had always met its external obligations and had had experience of economic adjustment under previous arrangements with the Fund. There was nothing abnormal in the present situation, other than the 1984 drought, which had forced Burundi to seek food aid for the first time since independence. Some of the problems facing the country were deep-rooted, requiring a structural adjustment loan from the World Bank, whereas others fell within the purview of the Fund. The two institutions must move together so that short-term measures could be integrated into a long-term program as smoothly as possible.

While it could be argued that all least developed countries needed to adjust and to cover any financing gaps by obtaining resources on concessional rather than on market-related terms, Mr. Abdallah stated, it

had to be recognized that an adjustment program supported by the Fund was an inescapable prerequisite for securing structural adjustment loans on IDA terms and additional concessional aid on a bilateral basis. It was partly because of the importance attached to the catalytic role of the Fund by all sources of financing that the Burundi authorities had been pressing for the dispatch of a Fund mission to discuss an arrangement.

The Burundi authorities had always cooperated with the Fund, and the staff reports had revealed no basic differences of view between them and the staff since the previous Article IV consultation, Mr. Abdallah observed. The authorities fully recognized the need for adjustment and had in fact taken a number of measures to that end, as the staff had acknowledged while stressing that what had been done had not been sufficient. In the cooperative spirit existing between the authorities and the Fund, early action should be taken to work out a comprehensive and realistic adjustment program to help the country out of its present difficulties. The staff's detailed analysis and appraisal of the Burundi economy clearly pointed to the areas of weakness and to what might be done to correct them.

The Chairman informed Executive Directors that if a structural adjustment loan was successfully concluded with the World Bank, it would be on IDA terms. The Fund itself would be holding discussions with the Burundi authorities in coming weeks to consider some of the main questions that would have to be answered before a full-fledged negotiation on use of Fund resources could be envisaged. Those questions included in particular the important issue of the exchange rate, which affected the balance of payments, government finance, and producer prices for various crops. Second, in order to examine the balance of payments projections for the medium term, the Government would have to provide information that it was preparing on the amount of foreign assistance and various assumptions relating to import liberalization. Third, the Government's financial operations for the coming three or four years would have to be discussed with the authorities, with particular consideration being given to some of the recommendations by the Fiscal Affairs Department relating to measures to raise revenue and to the need to ensure a viable balance of payments position in the medium term without an intensification of restrictions. It would also be necessary to consider a monetary and interest rate policy that would encourage savings and improve resource allocation. The work to be carried out by the Fund mission would be dovetailed into the final stage of a World Bank mission on structural problems. Thus, the two institutions would be working in parallel and in the best interest of the country.

The last personal remark he wished to make, the Chairman added, concerned the debt service ratio of Burundi. As could be seen from Table 3 of the staff report, the ratio was still below 20 percent of exports of goods, nonfactor services, and private transfers, but was on an upward trend, and would reach 22 percent, 25 percent, 31 percent, and 35 percent between 1986 and 1989, if debt service on financing the balance of payments

gaps was included. The country's debt servicing problems would be rendered more difficult if its use of Fund resources was too great, although of course the Fund could play its usual catalytic role.

Mr. Zhang considered that it was extremely important, especially if the Fund was going to negotiate an adjustment program with the member, to clarify the rationale for the staff's advocacy of a devaluation. The staff representative had argued that exchange rate depreciation would help to stimulate the exports of manufactures from Burundi. However, it appeared from page 17 of the report on recent economic developments in Burundi (SM/85/117) that "the structure of the manufacturing sector is characterized essentially by import-substituting industries geared toward meeting domestic demand for basic consumption goods. Export industries are limited mainly to agro-processing activities relating to coffee, tea, and cotton...and to a much lesser extent to consumer and intermediate products produced also for the domestic market (for example, beer, carbonated beverages, cigarettes, and fibro-cement)." Exchange rate depreciation would thus have a far greater impact on imports, which were mainly capital goods and raw materials, than on exports of manufactures.

The staff representative from the African Department noted that Burundi had the capacity to produce enough beer, cigarettes, and fibro-cement to export those commodities to markets in the region. Exports of beer, the dominant activity in the manufacturing sector, would benefit the most from an appropriate exchange rate policy. Furthermore, as he had already mentioned, if the authorities intended to adopt an appropriate producer price policy, they would need to find the resources to do so without increasing pressures on the budget. Finally, in addition to coffee, which accounted for most activity in the export sector, other crops were produced that were not subject to export quotas, such as tea and cotton. Therefore, a more appropriate exchange rate might help the Burundi authorities to diversify cash crop output for export.

The Chairman, in response to a further question by Mr. Zhang, noted that one of the subjects that should be discussed between the staff and the authorities would be the contribution that a depreciation of the currency could make to the development of certain export markets.

The Chairman made the following summing up:

Directors generally agreed with the substance of the appraisal in the staff report for the 1985 Article IV consultation with Burundi. They noted that in recent years economic growth had been negative, owing partly to adverse weather conditions and structural constraints, and of course to Burundi's landlocked position, but also to inadequate domestic policies, including overly ambitious investment programs, and that inflation had accelerated. They viewed with concern the increasingly large financial imbalances in the public sector, which had been financed by borrowing abroad and by bank credit. These developments in turn had weakened the external accounts,

the level of reserve holdings had been reduced sharply, and the external debt burden had become a source of major concern. Directors noted that the authorities had attempted to stem the worsening financial trends by devaluing the Burundi franc by 30 percent in November 1983 and by efforts to reduce the budget deficit in 1984. However, the intensification of restrictions in 1984 and the deterioration in the overall balance of payments position indicated that exchange rate and demand management policies were not adequate. Directors urged the Burundi authorities to implement without delay a comprehensive stabilization and adjustment policy to deal effectively with the financial imbalances.

Given the structural difficulties confronting Burundi's economy, Directors welcomed the authorities' decision to work closely with the World Bank to implement structural adjustment policies, including investment only in productive projects and in the rehabilitation and restructuring of the parastatal sector. The investment policies must pay due regard to domestic financial constraints and avoid unduly large recourse to domestic bank borrowing, or to foreign borrowing other than on concessionary terms or in the form of grants. Further external borrowing must take into account the constraints stemming from the debt profile of the country.

Directors noted that the authorities had requested a mission to begin discussions on a financial program that could be supported by a stand-by arrangement with the Fund. With the IBRD taking the lead as usual in working with the authorities to design the policies and reforms required to resolve the structural problems, those initiatives could hopefully be complemented with a carefully devised Fund-supported financial program. Directors emphasized that government policies will need to adequately restrain aggregate demand, improve relative pricing thereby also improving the quality of export products, strengthen competitiveness, and improve resource allocation and production possibilities over the medium term.

Directors stated that the Government's budgetary policies should play a central role in the adjustment process, and that early measures should be taken to reduce significantly the overall budgetary deficit and to limit the buildup of domestic and external debt. The need for a thorough revision of the 1985 budget was stressed. Directors emphasized the importance of cutting back expenditures, in particular subsidies to parastatals, which was the intention of the authorities, and non-priority capital outlays. They also emphasized that revenue should be raised through strengthening and refining the taxation system, noting in this connection the recommendations of a Fund

technical assistance mission. Expenditure control and budgetary procedures should also be improved to prevent any further buildup of domestic arrears and to start eliminating existing ones.

With regard to exchange rate policy, most Directors who spoke emphasized that the appreciation of the Burundi franc that had taken place since the last devaluation needed to be corrected, and that a flexible exchange rate policy should be adopted in order to strengthen the competitiveness of the export sector and encourage import substitution. Such a policy would have to be undertaken very carefully, with a view to the medium-term viability of the balance of payments and paying due regard to the required blend of fiscal and external adjustment.

Directors stressed that the implementation of the recommended policies should help Burundi to phase out existing restrictions on trade and on current transfers, and contribute to the revival of confidence in the economy on the part of the private sector and foreign investors.

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

The Executive Directors then took the following decision:

1. The Fund takes this decision relating to Burundi's exchange measures subject to Article VIII, Section 2 and in concluding the 1985 Article XIV consultation with Burundi in light of the 1985 Article IV consultation with Burundi conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Burundi continues to maintain restrictions on payments and transfers for certain current international invisible transactions, as described in SM/85/111. The Fund encourages the authorities to pursue policies which will permit the prompt elimination of existing exchange restrictions.

Decision No. 7971-(85/72), adopted
May 8, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/71 (5/6/85) and EBM/85/72 (5/8/85).

2. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/85/118 (5/6/85) is approved.

APPROVED: February 19, 1986

ALAN WRIGHT
Acting Secretary