NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/159

10:10 a.m., November 1, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. Lundsager, Temporary
	G. Ercel, Temporary
B. de Maulde	S. de Forges
M. Finaish	
	M. Sugita
	W.-R. Bengs, Temporary
	Jaafar A.
	J. Hospedales, Temporary
	R. Fox, Temporary
	I. Puro, Temporary
	G. D. Hodgson, Temporary
	A. Abdallah
	M. A. Weitz, Temporary
	J. E. Suraisry
	J. de la Herrán, Temporary
	A. Steinberg, Temporary
	A. V. Romuáldez
	B. Tamami, Temporary
	A. S. Jayawardena
	N. Coumbis
	Jiang H.

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

Also Present

IBRD: N. M. Gorjestani, Western Africa Regional Office. African Department: A. D. Ouattara, Director; J. Artus, J. R. Hill, P. Marciniak. Exchange and Trade Relations Department: S. Kanesa-Thasan, P. Neuhaus. Legal Department: P. L. Francotte, Ph. Lachman. Research Department: R. A. Franks, D. Folkerts-Landau, K. P. Regling. Treasurer's Department: D. Berthet. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, J.-C. Obame, A. Vasudevan. Assistants to Executive Directors: A. Bertuch-Samuels, S. Geadah, V. Govindarajan, J. M. Jones, H. Kobayashi, A. H. Mustafa, J. K. Orleans-Lindsay, V. Rousset, M. Sarenac.

1. MAURITANIA - 1985 ARTICLE IV CONSULTATION AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1985 Article IV consultation with Mauritania and a review under the stand-by arrangement, together with proposed decisions concluding the Article XIV consultation and the review (EBS/85/239, 10/1/85). They also had before them a report on recent economic developments in Mauritania (SM/85/270, 10/18/85; and Cor. 1, 10/29/85).

The staff representative from the African Department observed that Mauritania had made the two payments to the Fund that had been due on October 23, 1985. The late payment had been due to administrative problems in Mauritania and technical delays on the part of the paying agents. Mauritania had thus become current in its payments obligations to the Fund.

Mr. Alfidja made the following statement:

For a number of years, Mauritania has been suffering from the adverse effects of recurrent drought and a weak demand for iron ore, the country's principal export commodity. These two major factors, together with insufficient agricultural producer incentives and unsatisfactory performance of the public enterprise sector led to wide fluctuations in overall economic activity and large internal and external financial imbalances.

Since 1980, the authorities have attempted to redress Mauritania's economic and financial difficulties and the implementation of several adjustment measures has led to some improvement in economic and financial performance. In 1983 especially, substantial growth of real GDP and lower inflation were recorded. Encouraged by this outcome, the Mauritanian authorities reinforced their efforts to further reduce the internal and external imbalances during 1984. They continued to pursue tight fiscal and credit policies, depreciated the currency, adopted a flexible exchange rate policy, carried on with the program for the rehabilitation of the public enterprise sector, and took measures to liberalize the pricing and marketing system. Despite these efforts, the Mauritanian economy experienced a setback in 1984, when real GDP was estimated to have declined mainly because of poor performance in the fishing sector and the adverse effects of the drought on the economy. On the other hand, a considerable improvement in financial operations was registered in the same year. For example, the deficit on treasury operations (on a commitment basis) declined from about 5 percent of GDP in 1983 to 2 percent of GDP in 1984 and the restraint on credit expansion was maintained. Likewise, the current account deficit (including official transfers) was significantly reduced to less than 20 percent of GDP in 1984, from 28 percent in 1983.

In furtherance of their objective of achieving balance of payments viability in the medium term, the Mauritanian authorities undertook a financial program in early 1985 supported by a 12-month stand-by arrangement with the Fund. This first review, as explained in detail in the staff report, shows that the Mauritanian authorities are making steady progress toward achieving the objectives of the program.

In the real sector, it was possible to attain the projected increase in real GDP of 2.5 percent for 1985 because of favorable developments such as the effects of better weather conditions and reinforcement of the fishing policy aimed at controlling and monitoring the fish catch on the high seas and promoting artisanal fishing. Furthermore, some improvement in world demand for iron ore is expected to enhance output in the mining sector. The measures that have been taken to rehabilitate the public enterprise sector are also expected to have a positive impact on output. The Mauritanian authorities have initiated a new public investment strategy which is based on the Economic and Financial Recovery Plan for 1985-88. This strategy emphasizes the development of the rural sector, the rehabilitation of projects, and provides incentives for the expansion of domestic and foreign private investment.

In recognition of the need to correct the weaknesses in the pricing and marketing system, the Mauritanian authorities have increased the administered prices of several imported goods. The results of the study on the marketing and pricing system of Mauritania to be completed by end-October 1985 would enable the authorities to take additional action to gradually liberalize prices.

In the fiscal sector, the authorities are reinforcing measures for achieving a further reduction in the consolidated government deficit. In particular, public employment is being restrained and a balance is being kept between entries into and departures from the civil service. Civil servants are being encouraged to transfer to the private sector whenever possible. To ensure that revenue collection does not fall short of the program objectives, the authorities are continuing to strengthen tax administration.

In support of the other adjustment measures, the authorities have continued to follow cautious monetary and credit policies, which have kept the rate of domestic credit expansion within the limits set under the program. Furthermore, while awaiting the recommendations of a study jointly financed by the World Bank and the Arab Monetary Fund on the rehabilitation of the banking sector, the authorities have attempted to alleviate the impact of the severe lack of liquidity by allowing domestic and foreign private equity participation and by negotiating several moratoria with foreign creditors. Other important measures for achieving a reduction of the large domestic and external financial imbalances were the flexible exchange rate policy and the gradual depreciation of the real effective exchange rate of the ouguiya. The authorities are maintaining this policy stance so as to achieve a further improvement in Mautitania's external competitiveness in the context of changing circumstances.

In sum, my Mauritanian authorities are determined to pursue their ongoing efforts to revive the economic activity and gradually eliminate the financial imbalances that their economy has been experiencing.

Mr. de Maulde remarked that over the past two years the Government of Mauritania had conducted a major adjustment effort that was bringing about an improvement in most of the economic indicators. The external current account deficit had been cut down, as had the budgetary deficit; inflation had been brought under control; and GDP was expected to register an increase of 2.5 percent in 1985. Mr. Alfidja had provided a full and concise summary of the courageous and coordinated measures that had made that improvement possible, the most instrumental among them being the reduction in real terms of civil service salaries; the freezing of recruitment in the civil service; the adjustment of cereal prices at the producer and consumer levels; and finally, the flexible management of the exchange rate.

The Mauritanian Government should be commended both for its strong commitment to the program and for the flexibility it had demonstrated in adjusting its policies when necessary to cope with adverse developments beyond its control, such as recurrent drought and erratic fluctuations in the price of iron ore, Mr. de Maulde continued. Those policies would have to be maintained and strengthened in certain respects, such as the liberalization of prices and improved tax collection, in order to continue to put to good use the financial support extended by bilateral and multilateral donors in connection with the Fund-supported program.

Mauritania had a long way to go before it could achieve medium-term balance of payments viability, Mr. de Maulde noted. Until at least the end of the 1990s, Mauritania would continue to need strong financial support to help manage its external debt service obligations, which in 1986 would account for about 51 percent of export receipts. In that respect, he reiterated his regret at the low level of the Fund's support which, during the period of the stand-by arrangement, would entail a negative net transfer of resources that seemed out of line with the contribution being made by the rest of the international community.

Concerning the overall productivity of the real economy, the Economic and Financial Recovery Plan for 1985-88, to which Mr. Alfidja had referred, appropriately placed reference on the rural sector as well as on the rehabilitation of past projects that were currently underperforming, Mr. de Maulde remarked. The World Bank was making a valuable contribution to the implementation of that Plan through its own programs, as well as indirectly through the channel of the Mauritanian Development Bank. The latter's effort, which was directed toward the private sector, could perhaps be supported by the International Finance Corporation, at least in the form of technical assistance. Mauritania was also likely to benefit from the World Bank's Special Facility for Sub-Saharan Africa, a particularly appropriate outcome since the main purpose of that facility was to support the type of policy reform that Mauritania had been undertaking over the past two years.

Mr. Finaish observed that economic activity in Mauritania had contracted significantly in recent years due mainly to adverse weather conditions and a deterioration in the external terms of trade. Depressed economic activity, along with inadequate economic adjustment at an early stage, had given rise in turn to relatively large financial imbalances in the fiscal and external areas of the economy. That situation had led the authorities to reorient their economic strategy early in 1985 toward stronger and more comprehensive adjustment. In particular, they had adopted the Fund-supported program under review along with a medium-term recovery plan for 1985-88 that had been prepared with the help of the World Bank. The program supported by the stand-by arrangement had been kept on track; all the performance criteria had been met with the exception of the criterion pertaining to external commercial arrears, which had also been met shortly after the end-June deadline. With respect to the financing gaps in the budget and balance of payments, there was strong indication that they would be covered satisfactorily. The progress achieved so far toward the restoration of sustainable growth and balance of payments viability was encouraging, and the authorities' determined commitment to the pursuit of strong adjustment was cause for optimism.

Recent estimates indicated that the economic outturn for 1985 was likely to be favorable and broadly in line with the objectives of the program under the stand-by arrangement, Mr. Finaish continued. Economic growth was expected to pick up significantly along with a low rate of inflation, despite the substantial devaluation that had taken place earlier in the year. Higher agricultural output was anticipated, if the improved weather conditions continued, and the iron ore sector was recovering as a result of better external demand and the rehabilitation of the mining company. The fishing sector's prospects had improved as well but the contribution of that sector to economic growth could still perhaps be increased significantly by a reinforcement of Mauritania's control over its fishery resources. The staff might wish to comment on the recommendations of the World Bank study that had been prepared to assist the authorities in formulating their strategy for that important sector.

Further progress toward the restoration of sustainable growth and balance of payments viability was expected as a result of the adjustments undertaken in respect of the exchange rate, pricing policies, the rehabilitation of the public enterprise sector, and the rationalization of public sector investment, Mr. Finaish noted. The exchange rate devaluation had reversed the earlier appreciation and strengthened external competitiveness. Most producer and consumer prices had been increased with the objective of reflecting the impact of the devaluation. The rehabilitation of public enterprises had continued and a number of enterprises had been closed down or transferred to the private sector. Public sector investment had been scaled down substantially and reoriented toward rehabilitation and other quick-yielding productive projects. The choice of public sector reform policies should be made with caution in order to reduce the possible transitional costs due to the significant role played by the public sector in the Mauritanian economy.

Financial policies under the program had been generally on track during the first half of the year, Mr. Finaish added, and the program targets for 1985 in the fiscal and monetary areas appeared to be achievable. The overall fiscal deficit was targeted for a significant reduction through a number of revenue-raising and expenditure-saving measures. Various excise taxes had been converted from specific to ad valorem rates and tax collection had been strengthened. Civil service salaries had been raised by a limited amount in nominal terms and would continue to fall in real terms. A freeze was being maintained on military expenditure and the level of public employment. In addition, the elimination of the Government's domestic arrears could contribute to improved fiscal management. Credit to the Government had declined and total domestic credit had remained constant during the first half of 1985. Taking into account the capitalization of interest on nonperforming loans, credit to the nongovernment sector had been too tight; hence, the upward revision of the credit ceilings over the second half of 1985 seemed appropriate. The banks faced a severe liquidity shortage but action in that area had remained limited in scope since an in-depth rehabilitation of the banking sector awaited the findings of a related study financed by the World Bank and the Arab Monetary Fund. The structure of interest rates had, however, been raised to adequate levels in real terms.

In the external sector, the current account of the balance of payments had shown a significant improvement in 1984 and a similar improvement was expected in 1985, but the overall external position remained weak, Mr. Finaish concluded. The debt service ratio was relatively high but the outcome of the gap-filling exercise had been favorable; as a result, the authorities expected to eliminate all external payments arrears as targeted in the program. The medium-term scenario prepared by the staff indicated that balance of payments viability was likely to be achieved in the early 1990s. Meanwhile, the projected external gaps would require an appropriate combination of strong adjustment and adequate donor support. Finally, like Mr. de Maulde, he noted once again the low level of the support extended by the Fund to Mauritania to which he and others had referred when the request for a stand-by arrangement had been discussed by the Executive Board.

Mr. Suraisry commended the Mauritanian authorities for the strong adjustment efforts they had made to reverse the contraction in the productive base of the economy and to reduce the large fiscal and balance of payments imbalances. The policies formulated in the context of the Fund-supported program addressed those problems effectively. All the key actions under the program had been taken and all the performance criteria had been met, with the minor exception noted in the staff report. Given the scope of the needed adjustment, however, there was very little room for slippage. As the staff projections showed, even with favorable assumptions and the full implementation of appropriate policies, a viable balance of payments would not be attainable until the early 1990s, underscoring the importance of a sustained adjustment effort.

While the program was currently on track, a number of additional measures, particularly in the fiscal, parastatal, and monetary areas, were required to achieve the program's objectives, Mr. Suraisry went on. The fiscal performance in the first part of 1985 had fallen short of expectations as budgetary revenues were significantly below those programmed. There was therefore an urgent need to strengthen tax collections. With respect to expenditures, while the measures to control the growth of current spending were in the right direction, additional steps would have to be taken to achieve a satisfactory fiscal stance over the medium term. Furthermore, the authorities needed to accelerate their efforts to improve the fiscal accounts of the parastatal sector and, consequently, the public finances. In fact, the need to improve the performance of public enterprises went beyond strengthening the public finances. The parastatal sector accounted for about one fifth of GDP, one fourth of formal sector employment, and about one fourth of Mauritania's external public debt. Thus, efforts to rehabilitate that sector would go a long way to improve the performance of the economy in general and to generate additional savings in particular.

The authorities had made commendable efforts to improve the parastatal sector, Mr. Suraisry remarked, but as they well knew, the accounts between the Government and the public enterprises would have to be settled, and increased price liberalization undertaken, in order to put the public enterprises on a sound financial footing. As a result, the allocation of resources in Mauritania would be improved. In that connection, he welcomed the World Bank's involvement in the rehabilitation of the electricity and water company.

He welcomed the authorities' strategy of scaling down the public investment program and of concentrating on projects that were likely to enhance the economy's productive base, Mr. Suraisry said. Successful implementation of the Government's new investment policy, which had been prepared in cooperation with the World Bank, was a fundamental element in the improvement of Mauritania's balance of payments and growth prospects over the medium term.

Monetary policy in Mauritania had been supportive of the adjustment effort, as indicated by the low rate of growth of credit, Mr. Suraisry noted. Together with a prudent incomes policy, monetary policy had contributed effectively toward controlling the rate of inflation in view of the depreciation of the exchange rate. The authorities had taken several steps to alleviate the problems being faced by the commercial banks. However, additional measures to rehabilitate the banks were essential to ensure a more effective monetary policy and to make the financial system more supportive of the private sector. With the assistance of the World Bank and the Arab Monetary Fund, the authorities were currently examining in depth possible ways to rehabilitate the banking sector; he hoped that the study would have the expected results.

Externally, the authorities had adopted a flexible exchange rate strategy which also aimed at improving further the competitiveness of the external sector, Mr. Suraisry remarked. The continuation of that policy was of importance, especially since exports in the first four months of the year had been below, and imports above, what had been programmed. On a related point, Mauritania's external debt was substantial, exceeding 150 percent of GDP, and its debt service ratio was likely to remain high for some time. Mauritania would therefore require continued debt relief. In that context, he had been pleased to note that Mauritania had been able to eliminate part of the arrears on its public and publicly guaranteed external debt. He encouraged the authorities to eliminate the remaining arrears as soon as possible.

Mauritania's outstanding use of Fund resources under the current stand-by arrangement would reach 79.4 percent of quota by end-March 1986, Mr. Suraisry observed. The extent of Fund support for a program was of course determined by the member's balance of payments need and the strength of its adjustment effort. Mauritania's external sector and the financial imbalances in the economy would remain for some time and therefore so would its balance of payments need. The authorities had also demonstrated their willingness to take courageous decisions and strong measures of adjustment; they would no doubt continue to do so, and he hoped that those points would be taken into account if a follow-up program was considered.

Mr. Coumbis joined other Directors in commending the authorities for their efforts to adjust the economy in 1985. The results of the first review indicated that the program was on track. With one minor exception, all performance criteria for end-March and end-June had been observed, and the macroeconomic targets had been more or less met.

The inappropriate policies followed in the 1970s had created structural imbalances, Mr. Coumbis continued, and the medium-term scenario indicated that the balance of payments would be viable only at the beginning of the 1990s, provided that the comprehensive adjustment of the economy would continue throughout the rest of the present decade and that donor countries would fill the balance of payments financing gap during that period. For that long-lasting effort to be successful, the authorities would have to secure the conditions for satisfactory growth rates. Therefore, special weight should be given to supply-side measures in the adjustment effort. At the same time, the World Bank, in cooperation with the Fund, the creditor banks, and donors would have to secure the funds necessary to finance the five-year development plan.

The preparation of the Economic and Financial Recovery Plan for 1985-88 with the cooperation of the World Bank was a first step in the direction of a systematic development effort, Mr. Coumbis commented. The Plan envisaged the reduction of public investment to 20 percent of GDP and encouraged the development of private domestic and foreign investment. It was clear from the staff report that public investment had been poorly managed, that it had a very low yield, and that the very high rates of increase in investment during the 1970s had contributed greatly to the misallocation of resources. Therefore, by confining public investment to projects that enhanced production and improved the balance of payments, the development potential of Mauritania would be strengthened in the medium term. It was not clear, however, whether private investment could substitute for public investment activity in the short run. As the staff had indicated in its appraisal, the private sector was quite limited in size and its abrupt liberalization could be abused by private monopolies. It was also unclear how GDP would increase in 1985 following the reduction of public investment. Additional information from the staff in that respect would be helpful. Substantial progress had been made in rehabilitating public enterprises but obviously much more had to be done. Fortunately, the authorities were cooperating closely with the World Bank in that field as well.

As for fiscal policy, Mr. Coumbis said that he welcomed the decision of the authorities to broaden the tax base and to maintain a freeze on public employment. He stressed the need for a significant part of the expansion of the productive base to be financed by domestic savings and for the major share of those savings to come from public enterprises and the Central Government. As for credit policy, the authorities had rightly decided to increase interest rates and strengthen the Central Bank's monitoring of commercial banks. He hoped that the study on strengthening the banking sector would have been finished before the end of 1985.

By increasing official prices to reflect the effects of the exchange rate adjustment, the authorities were moving in the right direction, Mr. Coumbis concluded. However, he urged them to complete as soon as possible the study on the gradual liberalization of prices. He supported the proposed decision.

Mr. Bengs said that he had been glad to note that Mauritania was making good progress under the current stand-by arrangement, as indicated by its almost complete compliance with the performance criteria for end-June. There were also encouraging signs that the adjustment effort was beginning to bear fruit, most notably in terms of a revival of overall growth in an environment of diminishing domestic and external financial imbalances. Thus, the authorities were to be especially commended for the important measures they had taken relating to production and investment in the light of the widespread structural problems in the economy. The continued close collaboration between the authorities and the World Bank in those respects was highly welcome.

Nevertheless, it was clear that the progress achieved so far was no cause for complacency, Mr. Bengs continued. As the staff had rightly pointed out, the country was only in the first phase of an adjustment effort; determined efforts would be necessary to solve its serious structural problems. While he had taken note of a number of praiseworthy steps that had been taken already, he was somewhat concerned about the delays in implementing certain of the principal policy measures enumerated in Appendix II of the staff report. Furthermore, the apparent lag in attaining the envisaged performance in respect of the budget and the external trade accounts was a matter of some concern. With the downward revisions of the medium-term balance of payments projections, Mauritania faced an even more difficult outlook. The latest downward revisions to the export projections for 1985, indicating the vulnerability of the country to external shocks, argued in favor of a flexible policy stance that would allow for a tightening of financial policies should the need arise. In addition, the extraordinarily large resource gap and the dramatic increase in scheduled debt service payments would require the authorities to make every possible effort to improve domestic savings, including the maintenance of positive real interest rates. He wondered whether the lowering of cash deposit rates, as apparently contemplated by the authorities, was consistent with that requirement.

On a presentational point, Mr. Bengs noted that the Mauritanian authorities had been prompted to request a waiver of the criterion on external payments arrears on guaranteed commercial loans for end-June because of its partial observance. He understood that the relevant criterion had been met after the test date. He asked whether it was possible legally for the breach of a performance criterion to be corrected retroactively, namely, by actual developments after the review date, thereby avoiding the need to submit the request for a retroactive waiver to the Board. It would also have been helpful if the statement in the staff report (EBS/85/239) that the remaining purchases were scheduled to be made in three quarterly drawings of SDR 2.4 million had been consistent with the different drawing schedules shown in Table 1 of that report. Finally, he endorsed the staff appraisal and the proposed decisions.

Ms. Lundsager recalled that when the Executive Board had approved Mauritania's request for a stand-by arrangement in April (EBM/85/58, 4/12/85), her chair had commented that a significant rate of adjustment was expected--and was indeed required--under the program if a sustainable balance of payments position was to be attained in the medium term. The review provided the assurance that the program was broadly on track, as indicated by the adherence to all performance criteria with one slight delay in the implementation of programmed policy adjustments. That performance should permit the attainment of the fiscal and current account targets for 1985.

It was also reassuring to learn that the authorities were committed to passing through any future exchange rate adjustments to domestic prices, Ms. Lundsager added. Such pass-throughs should enhance the incentives for domestic production, including the output of viable import competing industries, such as food, if weather conditions were favorable. In the same vein, she welcomed the decrease in the number of items subject to administrative price control and recommended that further decontrol follow shortly, including the decontrol of marketing. It was somewhat disappointing to note that the study on liberalization had not yet been completed, because without increased flexibility in the movement of resources, Mauritania could not easily strengthen its productive base and generate sustained growth. In that respect, she concurred with the view that extreme care must be taken in the free distribution of food aid in order to preserve local producer incentives.

Furthermore, the major rehabilitation of public enterprises that was continuing with World Bank assistance was gratifying, especially the closure of unprofitable enterprises and the transfer of some to the private sector, Ms. Lundsager remarked. It would be interesting to know how far that divestiture effort had gone. The rationalization of the investment budget, including the focusing of investment away from large-scale infrastructure and toward the productive sectors, was especially appropriate to improve the medium-term prospects for Mauritania. The greater incentives for foreign investment mentioned in Mr. Alfidja's statement were thus welcome.

With respect to fiscal policy, the implementation of the programmed measures appeared to be resulting in the attainment of the fiscal target for the program year, although that would become more difficult with the shortfall in revenue, Ms. Lundsager continued. She noted that the authorities had frozen military expenditures at the 1984 level, one of the rare instances of an explicit mention in a staff report of the military budget. The authorities' willingness to address that issue was noteworthy. Substantial progress had been made in dealing with arrears--with domestic arrears having been eliminated and external arrears to be eliminated by the end of September. In addition, she concurred with the view that a strong administrative effort would continue to be required to ensure that tax collections came up to expectations. One area in which a strengthened effort might be needed was in the containment of the public sector wage bill, perhaps even by reducing employment. Difficult as that was, it would improve the budgetary situation and could facilitate the transfer of economic activity to the private sector.

The credit expansion programmed under the arrangement was fairly limited, Ms. Lundsager noted, and while restrictive credit ceilings were necessary to support the overall improvement in the balance of payments position, she wondered whether credit expansion was sufficient to support private sector activity, including the transfer of public enterprises to the private sector. In the past, private importers and public enterprises had been able to borrow abroad, a window that had since been closed. However, some private firms might have retained some working capital, and the elimination of domestic arrears might also have provided an infusion of cash. Some comment by the staff on the adequacy of the credit provided to the private sector would be helpful.

The medium-term outlook was based on the assumptions that domestic saving would become positive and that imports would grow by only 1 percent in real terms, Ms. Lundsager observed. At the same time, export projections had been revised downward and public transfers from abroad were projected to remain at around SDR 100 million. The conclusion to be drawn was that the economic outlook for Mauritania remained extremely fragile; with its already very high debt, a sustained adjustment effort, including adequate producer incentives, must continue to be the norm. She had been reassured by the staff's explanation for the delay in making certain payments to the Fund and supported the proposed decisions.

Mr. Abdallah commended the Mauritanian authorities on their very strong adjustment efforts which deserved the international support that he hoped would be forthcoming at the meeting of the Consultative Group for Mauritania, to be held in Paris at the end of November to review the Economic and Financial Recovery Plan.

The new exchange rate policy, coupled with the increasing efficiency and cost reductions resulting from the rehabilitation exercise being carried out in collaboration with the World Bank, as well as the onset of favorable weather should improve Mauritania's economic prospects in the near future, Mr. Abdallah observed. However, the expected improvement would call for perseverance in the adjustment effort; there was no room for complacency. The external current account, for example, was not expected to be in equilibrium before 1990, and debt service, which would absorb half of export earnings in 1986, would still be 30 percent by 1990 while the rate of growth of GDP would be only slightly higher than that of the population. Even those projections were optimistic, based as they were on favorable weather, and any deviation in the adjustment effort or in the amount of external assistance could change the outcome significantly.

The long-term outlook underlined the need for continued collaboration between Mauritania and the World Bank, Mr. Abdallah stated. The staff had explained how very high rates of investment in the past had been accompanied by a contracting economic base and dismal growth. The authorities had rightly decided to focus attention on the efficiency of capital investment, with the intention of raising productivity in existing projects, and to invest in projects of short gestation so as to improve the external position should be encouraged. There was still considerable potential to be exploited in the fishing sector and the new strategy being worked out to bring that sector more firmly under Mauritanian control should improve output, employment, and export earnings.

In concluding, Mr. Abdallah said that he endorsed the comments by Mr. de Maulde and Mr. Finaish about the low level of Fund assistance to Mauritania, which deserved stronger support by the Fund.

The staff representative from the African Department said that two recommendations in the World Bank report on the fishing sector were worth singling out. First, it would not be possible to develop the offshore fishing facilities in Nouadhibou until there was an adequate supply of electricity and water at a reasonable price. That was not true at present. Second, it would be necessary to train Mauritanians to become technically proficient fishermen. The vast majority of fishermen in Mauritania were not Mauritanian nationals. Those problems would be difficult to solve.

In order to avoid any misunderstanding with respect to Mauritania's external arrears, the staff representative explained that the program had called for the elimination of all arrears on public and publicly guaranteed debt by the end of September. The bulk of the arrears was to be covered by the agreement reached in principle by the Paris Club, which had given Mauritania until the end of December to sign the individual agreements with the countries concerned. Other creditor countries had also accepted the conditions agreed by the Paris Club. Although most of the arrears were covered by that agreement in principle, some arrears had had to be paid back in cash, namely, those to international organizations and to countries with which Mauritania was in arrears for relatively small amounts of less than SDR 500,000. Those arrears had been paid in cash before the end of September. Mauritania had therefore observed the requirement under the program to eliminate all arrears by the end of September 1985.

The increase in GDP in 1985 would stem, to a large extent, from the much better agricultural crop to be harvested in the months ahead, thanks to significantly improved weather, the staff representative said. The fishing sector was also expanding. The two sectors together should contribute to an expansion of GDP of 2.5 or even of 3 percent. The role of the private sector in the economy was extremely limited at present and it would take a very long time to enlarge that role and to increase private investment. That did not mean that a start should not be made.

It was because the staff itself had been concerned about the adequacy of the credit provided to the private sector that the credit ceiling for the second half of 1985 had been set somewhat above the indicative target initially set in the program, the staff representative explained. The fishing sector in particular had been in need of more credit and, to a much more limited extent, so had the agricultural sector.

The divestiture effort had not been carried nearly far enough to date, the staff representative noted. The public enterprises that had been closed or privatized were quite small and few in number. For all practical purposes, the program of rehabilitating the public sector had only just begun in 1985. The rehabilitation of the largest public enterprise had launched the effort, which would need to be strengthened.

The question whether the lowering of cash deposit rates was consistent with monetary policy would have to be explored in the context of the study on the banking sector and the study being undertaken on the consumer price index in Mauritania and the rate of inflation, the staff representative from the African Department said. The staff did not know exactly what the current rate of inflation was. The price index had not been reliable in recent months and it was being revised. As noted in the staff report, however, the rate of inflation was known to be relatively low. The major issue in the study on the banking sector, which would be available within a few days, was how to increase the rate of return of the primary banks as part of their rehabilitation. The commercial banks ran an extremely high risk in extending loans. Interest rates on cash deposits were almost the same as on time and savings deposits, and the question was how high to set lending rates and how to reduce rates on cash deposits in order to improve the rate of return.

The purchase that was scheduled to be made in the third quarter of 1985 had been postponed because of the delay in completing the review under the stand-by arrangement, the staff representative from the African Department explained. Therefore, instead of three quarterly purchases--one each in the third and fourth quarters of 1985, and one in the first quarter of 1986--there would be two purchases in the fourth quarter, one immediately after the completion of the review, and one when all the data through the end of September had been received. The final purchase would be made following the completion of the second review, probably in the first quarter of 1986.

The staff representative from the Legal Department explained that the stand-by arrangement for Mauritania provided that it could not make any drawings during any period if the data at the end of the preceding period showed that a performance criterion had not been met. The data for end-June had shown that arrears had not been eliminated as foreseen; therefore, in the period following the end of June, Mauritania could not have made a new drawing. However, the arrears had been eliminated shortly after the end-June date. At present, Mauritania was in a period in which the data for the preceding period showed that the arrears had been eliminated. Therefore, the drawing could be made without the need for a waiver.

Mr. Alfidja recalled that as he had mentioned during the previous discussion in the Executive Board of Mauritania's economic situation, the employment problem raised a sensitive issue and would not be resolved except in the longer term. One of the constraints to employment, and to the development of the fishing sector as well, was the lack of skilled workers. The authorities had on several occasions asked that in making recommendations with respect to employment policy, including the policy of hiring civil servants, the staff should take their unusually difficult situation into account. Nevertheless, they had confirmed their intention to encourage the maximum number of people to seek employment in the private sector, as he had mentioned in his opening statement. Employment policy was important and should be kept under close review, as no doubt it would be during the forthcoming mission.

In sum, Mr. Alfidja concluded, although the Mauritanian authorities were determined to discontinue some policies that were not compatible with their adjustment effort, they needed at the same time to avoid impeding the implementation of the necessary adjustment measures under the program, for instance, by not being able to find the necessary personnel.

The Chairman made the following summing up:

Directors commended the Mauritanian authorities for the strong adjustment measures implemented since early 1985 under the Fund-supported program. In particular, they welcomed the decisive supply-oriented measures, especially the significant adjustments of the real effective exchange rate and of real interest rates, the increases in cereal prices at the producer and consumer levels, the improvements in the selection of public investment projects, and the efforts to rehabilitate public enterprises. They also welcomed both the reduction in the consolidated government budget deficit resulting from an enhanced fiscal effort and the containment of government current expenditures, including a reduction in real terms of civil service salaries, and the cautious credit policy of the monetary authorities. They noted that, even though Mauritania's economy had continued to be affected by the protracted drought and the weakness of world demand for iron ore, the authorities had been able to keep the adjustment program on track and that the external position was improving while economic activity was picking up, with GNP forecast to increase by some 2.5 percent in 1985.

Directors observed, however, that Mauritania's internal and external imbalances remained very large and would require the continuation of firm adjustment policies for a number of years. They stressed that the need for further adjustment efforts was particularly great in the budgetary and public enterprise areas. The development of the Mauritanian economy required a positive and growing rate of domestic savings that would have to be derived largely from the central government budget and public enterprises because the private sector remained limited. Thus, the targeted surplus of current operations of the Treasury in 1985 should be viewed as a first step only, and Directors urged that there be no delays in the implementation of the fiscal program and its reinforcement. In 1986 and beyond, more substantial treasury surpluses and sizable cuts in the consolidated budget deficit would be needed. In that context, Directors commended the Government's recent decision to discontinue the automatic recruitment policy that had swollen the civil service, and they urged the authorities to strengthen tax collection and to reduce further the civil service wage bill in real terms. The rehabilitation of the public enterprise sector, currently carried out with the help of the World Bank, would also have to be strengthened in order to generate domestic savings through drastic productivity increases.

Directors also stressed the need to increase the private sector's role in the economy. They noted that there was an urgent need for bolder initiatives, especially as far as price and marketing liberalization was concerned, in order to strengthen the productive sectors of the economy, and that the full pass-through of exchange rate depreciation to domestic prices should be vigorously maintained. They also noted with concern the financial deterioration of deposit money banks and the effect that had had on the development of the private sector. In that regard, they urged the authorities to undertake a comprehensive rehabilitation of the banking sector.

Directors welcomed Mauritania's effort to restore a viable medium-term balance of payments and a basis for a sustainable economic growth through a recovery program for 1985-88 to be submitted to a Consultative Group meeting in late November. They welcomed the reduction in payments arrears and urged their full elimination, as planned, in 1986. In view of the sizable financing gaps that Mauritania is likely to experience in the next few years, and its heavy debt service obligations, Directors urged the authorities to fully implement the recovery program, in particular the planned significant shift in the Government's investment strategy toward quick-yielding projects in the rural sector, the rehabilitation of Mauritania's capital stock, and the containment of public investment. In that regard, Directors emphasized that continuation of generous donor support, as well as of the close cooperation between the Fund and the World Bank, would be critical in assisting Mauritania in its adjustment effort and in the closing of the large financing gaps.

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

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

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

2. Mauritania maintains a restriction on payments and transfers for current international transactions giving rise to external payments arrears, which is subject to approval under Article VIII, Section 2(a). The Fund welcomes the elimination of the multiple currency practice arising from broken cross-rates and urges Mauritania to eliminate the exchange restriction giving rise to external payments arrears.

Decision No. 8119-(85/159), adopted
November 1, 1985

Stand-By Arrangement

1. Mauritania has consulted with the Fund in accordance with paragraph 4(e) of the stand-by arrangement for Mauritania (EBS/85/41, Sup. 2) and paragraph 3 of the letter of the Governor of the Central Bank of Mauritania dated January 25, 1985, annexed thereto, in order to review policies and establish performance criteria for the second semester of 1985.

2. The letter dated September 17, 1985 from the Governor of the Central Bank of Mauritania shall be attached to the stand-by arrangement for Mauritania, and the letter dated January 25, 1985 shall be read as modified and supplemented by the letter of September 17, 1985.

3. Mauritania will not make purchases under the arrangement that would increase the Fund's holdings of Mauritania's currency in the credit tranches beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the limit on total net domestic credit of the banking system specified in paragraph 8 of the letter of September 17, 1985, or

(ii) the limit on net bank credit to the Treasury specified in paragraph 7 of the same letter has not been observed;

(b) after February 15, 1986, until the second review under the arrangement contemplated in paragraph 11 of the letter of September 17, 1985 has been completed.

4. In view of the understandings reached with Mauritania in the context of this review, the Fund decides that the review is completed and that Mauritania may proceed to make purchases under the arrangement.

Decision No. 8120-(85/159), adopted
November 1, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/158 (10/30/85) and EBM/85/159 (11/1/85).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 85/16 through 85/18 are approved. (EBD/85/273, 10/23/85)

Adopted October 30, 1985

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/85/263 (10/29/85) is approved.

APPROVED: June 12, 1986

LEO VAN HOUTVEN
Secretary