October 11, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 84/68

The attendance on the attached page 2 of the final minutes of Executive Board Meeting 84/68 (4/30/84) has been revised.

Att: (1)

Other Distribution:
Department Heads

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/68

10:00 a.m., April 30, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	w. B. Tshishimbi
J. de Groote	
	C. Flamant, Temporary
	M. Teijeiro
R. D. Erb	M. K. Bush
M. Finaish	
	T. Yamashita
J. E. Ismael	
R. K. Joyce	L. Leonard
	C. Robalino
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	
	T. de Vries
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
	A. Lindø
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: J. B. Zulu, Director; L. M. Goreux, Deputy Director; E. L. Bornemann, E. A. Calamitsis, A. Jbili, I. S. McCarthy, S. M. Nsouli, B. R. H. S. Rajcoomar, M. Sidibé. Central Banking Department: P. Duvaux. European Department: P. L. Hedfors. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; E. H. Brau, B. de Schaetzen, H. W. Gerhard, S. Kanesa-Thasan, D. Lee, E. B. Maciejewski, R. Pownall. Fiscal Affairs Department: R. D. Kibuka. IMF Institute: A. R. H. El Tayed, S. Zaid, Participants. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, S. A. Silard. Middle Eastern Department: P. Chabrier, Deputy Director; A. K. El-Selehdar, Deputy Director; J. G. Borpujari, P. L. Clawson, F. Drees, S. Geadah, S. H. Hitti, Z. Iqbal, S. Kawar, K. Nashashibi, A. Ouanes, G. Tomasson, M. Yaqub. Bureau of Statistics: T. T. Luu. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, H. A. Arias, C. J. Batliwalla, S. E. Conrado, S. El-Khouri, K. A. Hansen, S. M. Hassan, W. Moerke, J.-C. Obame, Y. Okubo, I. R. Panday, D. I. S. Shaw. Assistants to Executive Directors: R. L. Bernardo, M. B. Chatah, Chen J., L. E. J. M. Coene, M. Eran, G. Ercel, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, M. J. Kooymans, J. K. Orleans-Lindsay, G. W. K. Pickering, T. Ramtoolah, M. Rasyid, J. Reddy, D. J. Robinson, A. A. Scholten, N. Toé M. A. Weitz.

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1. ZAIRE - REVIEW UNDER STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered the staff report on the review under the stand-by arrangement for Zaïre and a proposed decision on Zaïre's exchange system (EBS/84/72, 4/2/84; and Cor. 1, 4/25/84).

Mr. Tshishimbi made the following statement:

I thank the staff for their excellent paper on the first review of the 15-month stand-by arrangement that was approved by the Executive Board on December 16, 1983. I would also like to express the appreciation of my authorities for the constructive approach that was adopted by the management and the staff during the period of the review.

The current stand-by arrangement became effective on December 27, 1983, after Zaïre's debt service obligations for 1983 and 1984 were reduced through a debt rescheduling by the Paris Club in December 1983. The debt relief from the Paris Club creditors totaled SDR 861 million. Debt restructuring by creditors that did not participate in the Paris Club meetings has not been arranged yet. However, the successful outcome of the Paris Club meeting has paved the way for negotiations with the non-Paris Club members, which will help to close the remaining financing gap.

For a full year before the Executive Board considered Zaïre's request last December, the Zaïrian authorities had already been taking strong corrective measures to reduce the financial imbalances. The results of these measures were very encouraging. The authorities placed strong emphasis on improving budgetary performance through greater fiscal discipline. By the end of the year, the overall budget deficit, which was about 9 percent of GDP in 1982, had been reduced to 2 percent of GDP, and the bank financing of the budget had been reduced significantly. Reflecting the favorable impact of the devaluation of the zaïre and the application of a new fiscal regime for the principal mining company, GECAMINES, as well as the impact of new revenue measures, total budgetary revenue reached Z 11 billion for 1983, compared with Z 6 billion for 1982. To restrain public spending, the authorities reinforced budgetary controls and gradually centralized all government operations under the Ministry of Finance. As a result, total budgetary expenditure was limited to Z 12 billion for the year, despite higher payments of external debt and nondebt arrears of the Treasury. For the first time in several years, the Government succeeded in controlling one key category of expenditures, the salary payments to primary and secondary school teachers. The only minor exception was an unforeseen minimal overrun in outlays of the political institutions.

The expansion in domestic credit remained within the initial targets. However, because of a major revision of monetary statistics, which was carried out with Fund technical assistance, the base period stock of net domestic assets of the banking system, as well as that of net credit to Government, was adjusted upward. The ceilings set for the end of 1983 were thus exceeded, thereby implying a breach in the performance criteria. In view of this, my authorities are requesting a waiver of the ceiling on net domestic assets of the banking system and of the subceiling on net credit to the Government for December 1983. They hope that the Executive Board will show understanding and flexibility and approve the request.

During 1984, my authorities intend to consolidate the gains achieved thus far by strengthening the policy measures already in place and by placing continued emphasis on budgetary discipline and on control of the liquidity in the economy. Accordingly, real GDP growth has been projected to show a notable improvement, from less than 1 percent of GDP in 1983 to about 2 percent in 1984. Inflation is expected to decelerate from 76 percent in 1983 to 49 percent in 1984.

The principal goal of the program is to reduce the budgetary deficit to less than 1 percent of GDP. Bank financing of the deficit will be limited to the original ceiling of Z 2.6 billion. To achieve this budgetary objective, expenditure controls will be strengthened and further steps are being taken in the centralization of government operations under the newly expanded Ministry of Finance and Portfolio. In addition, all expenditure commitments, as well as the debit of Treasury accounts with the Bank of Zaïre, will require prior authorization of the Ministry. These measures should help to prevent commitment of unbudgeted expenditures and the accumulation of arrears. Pending the completion of a comprehensive study on the overall staffing, the authorities have taken some unpopular measures concerning the Government's employees. In particular, they have decided to freeze employment and to remove persons from the payroll whose inclusion cannot be justified. Quarterly targets established for outlays on key expenditure categories, such as salaries and payments for school teachers and the political institutions, will be strictly enforced.

Budgetary revenue is expected to double in 1984. The devaluation of the zaïre and the application of a new fiscal regime for GECAMINES will continue to have a favorable impact on revenue. Even more important, perhaps, is the rehabilitation of the customs agency, OFIDA. With the benefit of multilateral technical assistance from the European Community to OFIDA and a revision of the tax rates following the depreciation of the zaïre, tax collection is likely to improve substantially.

With regard to public enterprises, the Zaïrian authorities are committed to improving their operations to make them financially viable and thereby reduce their reliance on the budget. The conference of heads of public enterprises held in January

1984 led to certain changes in some of the public enterprises' top management. To enable the authorities to take decisive measures in a medium-term perspective, a study has been undertaken, with the assistance of the World Bank, to improve the efficiency of the public enterprises.

In the credit and monetary area, the program envisages a substantial deceleration in the growth of money supply. Credit policy will continue to be selectively biased in favor of productive activity in the private sector in order to reverse the trend of previous years during which government borrowing absorbed most of domestic credit. The Bank of Zaïre will closely monitor this credit policy and ensure strict adherence to the quarterly ceilings established for commercial banks. In order to absorb the excess liquidity in the economy and to enhance a smooth and efficient interbank foreign exchange market, the authorities have decided to establish a money market through which holders of the zaïre are offered very remunerative returns. It is very encouraging to note that as of April 24, 1984 subscriptions to treasury bills have reached about Z 155 million, compared with the midterm target of Z 200 million at the end of June 1984. Furthermore, the authorities have raised the reserve ratio of the commercial banks and have already started to apply the penalty for nonobservance. Partly as a result of these measures, the exchange rate of the zaïre has stabilized around Z 35 per US$1 in the interbank foreign exchange market.

The substantial debt relief obtained from the Paris Club in December 1983 has had a significant impact on the balance of payments projections for 1984. However, the actual financing profile will depend on the results of the negotiations with individual official creditors and with the commercial banks. In order to consolidate the confidence in Zaïre's ability and determination to settle its overdue external financial obligations, all existing arrears have been paid to multilateral creditors and foreign governments. Negotiations on outstanding arrears and debt service with non-Paris Club officials have already started.

The actions taken by the Zaïrian authorities on the domestic as well as on the external front provide additional evidence that Zaïre is commited to pursuing strong adjustment policies in order to correct the internal and external imbalances that have persisted for so long in the economy, and to achieve a viable balance of payments position in the medium term.

My authorities are confident that the measures envisaged for 1984 will consolidate the gains achieved in 1983 by reviving production and promoting exports, thus further reducing distortions in the economy. My authorities are also aware that their efforts should continue to be vigorous in order to deal effectively with the bottlenecks that prevail in the agricultural, mining, and transportation sectors. They therefore renew their strong commitment to the implementation of the current program.

Mr. de Groote said that Zaïre's success in correcting its payments problems under a Fund-supported program was both a source of great satisfaction to the Fund and striking evidence of the worth of the policies it recommended. The staff appraisal's positive tone and content contrasted sharply with the apprehension about the possible nonimplementation of the program that had been expressed by several Executive Directors during the previous discussion on Zaïre (EBM/83/174, 12/16/83). It had been essential for the restoration of its credibility for Zaïre to demonstrate its readiness to undertake an unremitting effort to eliminate the major weaknesses in the economy.

Besides the obvious advantages for Zaïre of eliminating the diffidence and skepticism it had encountered in the past, Mr. de Groote continued, Zaïre's full implementation of the program was particularly significant for three main reasons. First, Zaïre's successful stabilization effort had not begun with the approval of the present stand-by arrangement in December 1983, but rather a full year earlier, when the authorities had agreed to implement a trial program embodying all the requirements of a stand-by arrangement. The list of measures implemented showed that some of the most important elements of the program had been in effect several months before Fund financing had become available. The consistency and continuity of the authorities' efforts over the previous 18 months showed that their program had strong roots in firm political decisions. Zaïre could no longer be justly criticized for the short-lived nature of its stabilization attempts.

The second reason, Mr. de Groote said, was that the successful implementation of a stabilization program over a long period had resulted in the correction of the two traditional weaknesses in the economy, as the public sector deficit had been reduced to less than 1 percent of GDP, and a flexible and realistic exchange rate had been introduced together with full import liberalization. The expected further increase in budgetary revenues of about 25 percent of GDP in 1984 was particularly commendable. In that connection, the effect of the devaluation on fiscal income, the significant and necessary increase in the tax on petroleum products, and the long-overdue decision obliging GECAMINES to pay taxes had been decisive. In addition, the recent special Fund staff mission had clearly concluded that the exchange market was operating effectively in Zaïre; its functioning was bound to be further enhanced by the tightening of monetary and credit policies over the coming three quarters, by the success of the first offering to the public of money market instruments denominated in national currency and offering an attractive yield, and by the progressive increase in the legal reserve ratio.

The effects thus far of the new exchange rate had been largely negative, Mr. de Groote remarked. Sizable consumer price increases had been unavoidable, although they had occurred much more slowly than expected by most observers due to the immediate impact of the liberalization of imports. The beneficial effects of the new exchange rate on the current account balance and on consumer income should gradually begin to materialize in the coming period. Exports had already begun to benefit because the present exchange rate permitted production costs to be fully covered, and because local manufacturing had become more profitable. Given the well-known resilience of the Zaïrian economy, something that was difficult to reflect in forecasts, it was highly probable that the results for the current account balance and for consumer income would be substantially better in 12 months' time than the staff had anticipated, provided that the policies on money and credit--including the monetary financing of the public sector--and the exchange rate policy were firmly maintained.

The anticipated positive response of the capital account would depend greatly on Zaïre's meeting both its obligations under existing reschedulings and its commitment with respect to the repayment of arrears to non-Paris Club creditors, Mr. de Groote commented. The performance clause relating to those obligations should not be treated as a matter of secondary importance by the authorities. The restoration of Zaïre's creditworthiness would be influenced mainly by the regularity with which the limited reimbursements envisaged under the present program were made. If all went well, Zaïre should soon find itself again an important recipient of capital, as justified by its unique development potential.

The third significant feature of Zaïre's program, Mr. de Groote said, was the strictly implemented incomes policy for the public sector, which had permitted the needed transfer of resources from internal absorption to the external sector. Although he had been more optimistic than most others when the incomes policy had been implemented, even he had not expected such a favorable outcome, which had been due mainly to the setting of predetermined nominal wage increases in the public sector, a risky stance given the difficulty in forecasting the behavior of consumer prices. The outcome of the critically important and courageous incomes policy had shown the correctness of the Bank of Zaïre's forecasts.

From a social viewpoint, Mr. de Groote remarked, the most difficult phase of the adjustment effort in Zaïre had been completed. Experience with all Fund-supported programs showed that the resumption of income growth was quickest and strongest when the adjustment had been rapid and substantial.

Given the likely recovery of incomes, Mr. de Groote continued, the main task for the future would be to achieve income increases that were consistent with current general economic conditions and would therefore not threaten the achievement of durable economic growth. A country like Zaïre, which depended heavily on favorable mineral prices, would undoubtedly be in a position to improve its external current account balance and its economic growth prospects if the recovery in the industrial countries was durable and was extended to other countries. However, the world economic outlook papers suggested that the prospects for primary commodity exporting countries for the coming three to five years were subdued. Those prospects were reflected in Table 7 of EBS/84/72, which summarized Zaïre's balance of payments outlook for the period 1983-90. Even if it was assumed that the price of copper would increase steadily through the 1980s by about 35 percent, Zaïre would not attain a current account surplus before 1988, and its financial situation would not be fully restored until near the end of the decade.

The implications of that forecast, Mr. de Groote went on, were important not only for Zaïre, but also for its creditors. The gradual restoration of a viable balance of payments position would require continued strict demand management policies for many years. Table 7 showed that the anticipated 75 percent increase in exports in the period 1984-90 must be accompanied by import growth of no more than 50 percent if balance was to be restored. Friendly countries and the banking community must be made aware that restoring external balance would require a large increase in public and private capital flows through rescheduling and new net lending. The difficulties attributable to inappropriate economic management had been eliminated, and Zaïre should be seen as one of the countries that had been particularly hard hit by excessive swings in foreign lending. Zaïre had initially been flooded with funds whose use had not been fully supervised, but it currently faced the adverse effects of the restrictive policies of the industrial world without having the financial resources to make needed adjustments. Indeed, Zaïre was a good example of a country that would greatly benefit from a system in which reimbursement obligations were closely linked to changes in a country's debt servicing capacity.

Zaïre would also benefit from closer cooperation between the Fund and the World Bank, so that, once the country's financial position had been sufficiently improved, the World Bank could take over from the Fund the task of monitoring the many structural adjustments needed to redirect production, organize a modern transportation network, and make other changes on which the effective use of Zaïre's potential greatly depended, Mr. de Groote remarked. The World Bank could support joint financing operations involving public and private financing sources. Cooperation between the Fund and the World Bank should lead to the establishment of policy objectives and to the identification of financing needs for a period much longer than that covered by Fund financial assistance alone. In that connection, the World Bank should do its part to prolong the provision of international assistance to Zaïre.

Parts of the staff report were unclear to him, Mr. de Groote said, and their opaqueness might be taken as a deliberate attempt by the staff to conceal some of its misgivings. The fundamental economic situation in Zaïre was clearly improving, an outcome that had not been expected by most observers, and it was important to describe that clearly. One of the unclear passages was at the top of page 3 of EBS/84/72, where a shift of SDR 383 million in the overall balance of payments position was apparently to be explained by a reduction of SDR 12 million in arrears.

Mr. Ismael considered that the authorities were to be commended for the progress they had made in implementing the adjustment program. They had observed all the performance criteria for end-December 1983. The many strong measures that they had introduced, particularly in the fiscal area and foreign exchange system, had significantly contributed to the restoration of confidence in the Government that was reflected in the substantial debt relief obtained by Zaïre through the Paris Club and from other creditors.

The remarkable fiscal progress was especially encouraging, Mr. Ismael remarked. And the exchange rate reform of September 1983 and the subsequent adjustments that had led to a unified market-determined exchange rate, together with the liberalization and simplification of the exchange and trade system, constituted another major advance toward a viable balance of payments position compatible with adequate and sustained economic growth. However, it was important to bear in mind that the authorities would undoubtedly continue to face difficult economic and financial challenges during the coming several years.

The staff, Mr. Ismael noted, had attributed the unsatisfactory performance of nonofficial external transfers in 1983 mainly to the larger than expected outflows on account of services, which included in particular interest payments on the public debt. That deterioration had been closely related to the high rate of inflation and the rapid depreciation of the exchange rate. In his view, however, the excessive rate of monetary expansion during 1983 had also played an important role; it was a cause for concern because it had occurred even though the authorities had remained within the ceiling on domestic credit expansion and had met the other performance criteria with a comfortable margin. The expected decline in monetary expansion in 1984 would be crucial to making further progress in correcting the external imbalance; to that end, additional measures would be needed to reduce the budget deficit and to improve the functioning of the money and interbank foreign exchange markets.

He had some difficulty in understanding the three factors mentioned by the staff as having been responsible for the slippage in achieving the targeted rate of liquidity expansion, Mr. Ismael said, and a further comment would be useful. One of the factors had been the considerable acceleration in the rate of budgetary outlays and in net credit to the Government in November and December 1983. Although net credit to the Government for 1983 as a whole had been within the program target, it had accelerated in the final two months of the year, thereby perhaps helping to explain the excess liquidity increase. Table 3 suggested that the expansionary effect of the movement in foreign assets, of the revaluation losses, and of other adjustments, had been larger than the staff had expected when setting the performance criterion on domestic credit. Under the program for 1984, domestic credit was to expand at the same rate as in 1983; therefore, caution would be needed to ensure that the expansionary impact of net foreign assets and of valuation adjustments would not be significantly larger than had been expected when the performance criterion on the expansion of domestic credit had been set. Otherwise, the objective of decelerating the expansion of the money supply would be jeopardized.

Further comment by the staff on the timeliness and advisability of the expansion of imports under the program for 1984 would be useful, Mr. Ismael said. Imports were expected to increase by 5 percent in 1984, compared with only 2 percent in 1983. The increase had been planned despite the projected slower increase in exports and unrequited transfers in 1984 than in 1983. Finally, the proposed decisions were acceptable.

Ms. Bush stated that the proposed decisions should be approved. Her authorities were pleased that the Government of Zaïre had made considerable progress in the area of budgetary control and had continued to make commendable efforts at exchange market reform. She understood the problems that the Government faced in establishing the new exchange market mechanism. The initial sale of Treasury notes had been successful, and further comment on recent developments in that area would be helpful. A fundamental problem with the new foreign exchange mechanism seemed to be a lack of confidence in the zaïre and a desire by Zaïrian citizens to hold foreign exchange whenever possible. The best solution to that problem might be to make domestic economic activity more profitable and to halt inflation.

The Government should be urged to consider increasing its efforts to reduce the rate of inflation, Ms. Bush considered. For instance, the money supply growth target for 1983 had been met, and it would be appropriate to keep the actual growth of the money supply in 1984 below the target shown in the staff report. A further comment on the efforts to control monetary expansion and inflation would be useful.

Improving the performance of, and confidence in, the economy, Ms. Bush continued, was essentially a developmental problem. It would be useful to have detailed information on the Government's efforts to increase private sector activity and foreign investment.

It was important to look at the medium-term projections for the government budget, Ms. Bush considered. In particular, because the operations of GECAMINES had been placed on a more businesslike basis that would enable it to finance its own equipment maintenance expenses, there might be a need for a proportional reduction in GECAMINES' payments to the Government.

The new performance criteria resulting from the February 1984 review did not cover all of 1984, Ms. Bush noted. Could the Executive Board be assured that all the necessary criteria would be established at the next review?

The arrears accumulated by Zaïre raised a broad policy issue which, although it was under study, was a cause for concern, Ms. Bush commented. It would be helpful to know the current status of arrears to non-Paris Club members, and the overall status of negotiations with official creditors and commercial banks.

Mr. Leonard recalled that during the previous discussion on Zaïre a number of Executive Directors had questioned the ability of the authorities to sustain an adjustment effort that merited Fund support. The staff report showed that economic developments in Zaïre through end-December 1983 had been encouraging, and that the authorities had continued to pursue the objectives of the adjustment program. In particular, they were to be commended for their readiness to tighten demand management policies, the reform of the exchange system, and the elimination of the temporary dual exchange rate arrangement. The proposed decisions were fully acceptable.

Nevertheless, Mr. Leonard continued, the recent surge in domestic liquidity and the rate of depreciation of the zaïre had made the economy even more vulnerable than hitherto while reducing the authorities' room for maneuver. To avoid a recurrence of earlier problems, the authorities should persevere in their commitment to implement additional adjustment measures and to promote confidence. Their effort to strengthen the interbank foreign exchange system must be vigorously maintained through both the monetary measures outlined in the staff report and tight control of the fiscal deficit.

The rate of inflation was a cause for concern, Mr. Leonard considered. The increase in 1983 in the price index for Kinshasa of 76 percent, compared with the target rate of 68 percent and the actual rate of 34 percent in 1982, was incompatible with the adjustment program. Although the high rate of inflation was attributable partly to the devaluation of the zaïre, it also reflected the acceleration both in the rate of increase in fiscal expenditure in late 1983 and in the rate of monetary expansion. He attached importance to the present nonaccommodating demand management stance as a means of moderating the rate of inflation.

Although the budget deficit had been reduced substantially in 1983, Mr. Leonard remarked, the recently introduced measures to ensure better control over public expenditures and revenues were welcome, particularly in view of the domestic currency cost of servicing the Government's external debt. However, additional measures were required. The authorities should be encouraged to complete the phasing out of subsidies to public enterprises as part of the much-needed improvement in their financial performance. The improvement was essential not only to ease the financial burden on the Government, but also to avoid tying up scarce resources in inefficient activities. The study being made in cooperation with the World Bank on the problems facing the public enterprises was also welcome, and he wondered when it would be available. Exposing the public enterprises to greater competition would be one way of increasing their efficiency.

The authorities were attempting to determine the exact number of civil servants as part of their effort to improve control over wage expenditure, Mr. Leonard noted. He hoped that the authorities could set a definitive target for reducing the size of the civil service.

While the large planned reduction in budgetary arrears was welcome, the arrears would still be larger in 1984 than had originally been planned, and the authorities should be urged to eliminate them as quickly as possible, Mr. Leonard continued. He wondered whether the authorities had given any further thought to the proposal for assigning a resident representative to Zaïre.

Improving the functioning of the interbank foreign exchange market was a key element of the adjustment program, Mr. Leonard commented, and the revival of the parallel exchange market, with its substantial premium rate over the interbank rate, was therefore a cause for concern. He agreed with the staff that the interbank foreign exchange market would not function satisfactorily while there was excess demand for foreign exchange caused in part by uncompetitive rates of return for zaïre-denominated bank deposits. Interest rates should be raised, so that they could compete with rates on foreign deposits. He hoped that the development of a treasury bill market would soak up some of the excess liquidity and give the banks more room to increase their deposit rates. The initial offering of treasury bills on April 3, 1984 had carried a rate of increase that was negative in real terms, and he wondered whether the low rate had detracted from the market's reception of the bills.

The emergence of a parallel exchange market in early 1984, Mr. Leonard commented, implied that the present system of exchange rate determination might not be sufficiently flexible. He wondered whether the staff had drawn the same conclusion, and whether consideration was being given to ways in which the present system could better reflect market conditions.

Tables 7 and 9 suggested that the medium-term balance of payments outlook remained bleak, Mr. Leonard remarked. Financing gaps were projected for the period 1985-88. The outlook underscored the need to adhere to the financial adjustment under the program if the problems facing the economy were to remain manageable. He hoped that the next review of the stand-by arrangement would confirm that the authorities had continued to make progress.

Mr. Finaish recalled that during the previous discussion on Zaïre he had voiced a number of reservations about the adjustment program itself and about its implementation by the authorities. The present staff paper painted a mixed picture of the implementation and of the outcome of the program, and some of his reservations had not been eliminated. The staff had noted some improvements that had apparently occurred in 1983, and particularly the reductions in the size of the fiscal deficit as a percentage of GDP, and in bank financing of the deficit. Those developments had, of course, been greatly facilitated by the substantial debt relief granted Zaïre.

During the previous discussion, Mr. Finaish went on, he had raised the question of Zaïre's arrears, and particularly those owed to multilateral development institutions. The recent settlement of arrears to the Arab Bank for the Economic Development of Africa was welcome.

However, Mr. Finaish continued, there had been a number of worrying developments during 1983: the external current account position had been worse than originally expected; the money supply had exceeded the target level by a substantial margin; the rate of inflation had exceeded the high target rate of 68 percent; and the rate of economic growth had been lower than had been anticipated. In addition, the small overrun in the outlays by the presidency and political institutions in 1983 had not helped to build confidence in the authorities' commitment to general economic reform.

Commenting on the program for 1984, Mr. Finaish said that Table 2 on page 21 showed that, in contrast to the staff's statement that the program objectives remained broadly intact, the target for the current account deficit in 1984 had been revised upward by a significant amount. Moreover, the overall external balance as well as the financing gap for the rest of the decade seemed worse than they had four months previously. The authorities had stated their intention to improve the monitoring and control of fiscal outlays, introduce measures to absorb excess liquidity in the system, and improve the efficiency of the financial sector in general. Those plans, in addition to the more serious effort to deal with the deteriorating public enterprise sector, would constitute, if implemented effectively, movement toward making the badly needed reforms.

The staff had noted on page 3, Mr. Finaish said, that "due to the inability of the Zaïrian authorities to reach debt restructuring agreements, arrears to creditors that were not participants in the Paris Club meeting increased by about SDR 57 million in 1983." The staff could usefully elaborate on the nature of the problem and on any agreement that had been reached with non-Paris Club creditors.

The money supply growth target for the period end-1983 to end-1984 was 36 percent, Mr. Finaish remarked, but the growth of the average money supply between 1983 and 1984 had been almost twice as rapid, roughly 67 percent. In the light of the expected increase in the velocity of money, the 67 percent average increase in the money supply might not be consistent with the target for nominal GDP growth of 51 percent. The same kind of problem existed with respect to the target for the rate of inflation of 49 percent, which apparently was based on changes in the average price index from 1983 to 1984.

The performance criteria in the staff report containing the proposal for the present stand-by arrangement (EBS/83/257, 11/30/83), Mr. Finaish remarked, had covered the period only through end-December 1983; the performance criteria for end-March 1984 were to have been set during the first review, which was to have been held sometime in February 1984. In fact, the performance criteria for both end-March and end-June 1984 had been set during the review that had actually taken place in mid-February 1984. He wondered whether Zaïre had been subject to any performance criteria during the six weeks prior to mid-February 1984. Such a gap could be seen as constituting a weakness in program design, especially as economic conditions had left the authorities little room for maneuver.

In addition, such a gap might cause subsequently established ceilings to be set at less desirable levels than would have been the case otherwise; that outcome might occur despite the existence of initial annual program targets. In setting new ceilings, the staff understandably had to take the current situation into account and, in some cases, the situation might have worsened because of inappropriate policies during the period not covered by performance criteria. The issue he had raised was related not so much to conditionality, as to the effective monitoring of an agreed adjustment program.

8 Mr. Lovato stated that the proposed decisions were acceptable. During the previous discussion on Zaïre, he had expressed some apprehension because of the country's poor record in implementing required corrective policies under Fund-supported programs. The experience with the extended arrangement for Zaïre had been particularly worrying; slippages and deficiencies in policy execution had caused fiscal developments to depart from the program path. He had stressed the need for prior policy actions in connection with the stand-by arrangement, and those actions had in fact been particularly helpful in setting in motion prompt adjustment in Zaïre; they had reduced the usual delay with which stabilization policies influenced real economic behavior, and they had had a positive announcement effect on rebuilding creditors' confidence and in restoring external financial flows. The good policy performance of Zaïre during the first several months of the stand-by arrangement was traceable to an important extent to those important characteristics of the program.

As for the 1984 program, Mr. Lovato said, it would be imperative for Zaïre to maintain fiscal discipline. On the revenue side, he was pleased that, despite some slippage in the collection of customs duties, the recently introduced measures and those that were to be introduced soon were expected to lead to a strong revenue performance. In the medium term, however, the authorities should give careful consideration to reforms that would enhance income taxation and reduce the present reliance on indirect taxes and trade-based duties; the fiscal performance would then be less dependent on the short-run revenue-generating effects of a devaluation. On the expenditure side, the authorities had given renewed emphasis to strict budgetary control. Two crucially important measures had been introduced in 1983, namely, the centralization of government spending authority at the Ministry of Finance and Budget, and the inclusion among the policy understandings that were to be continuously monitored with the Fund of quarterly targets on expenditure categories. Both steps seemed to have been effective.

In assessing domestic pricing policy, Mr. Lovato noted, the staff had made merely a brief reference to the present situation. Price liberalization had clearly progressed significantly in recent years, but some assurance about the Government's stance in the area of tariffs and public utility charges would be helpful. Was there an implicit indexation mechanism that linked periodic adjustments to the current, still very high, rate of inflation?

Monetary expansion in 1982 and 1983 had been substantial, Mr. Lovato commented. Restraint was needed, and the target of a deceleration of the rate of expansion in 1984 was welcome. However, he agreed with the staff that the techniques of monetary control should be improved so that the authorities could effectively monitor and absorb the excess liquidity in the banking system. In that connection, the recent decision establishing a money market for interest-bearing government securities was appropriate. He agreed with the staff that the new market should provide an incentive to banks to remunerate sight deposits adequately and should lead to an interest rate structure that was more consistent with the desired degree of monetary discipline. The new market could also encourage improvements in the savings ratio and in resource allocation.

The desired exchange and trade regime reform was far-reaching, and impressive progress in implementing it had been made, Mr. Lovato considered. However, some aspects of the external outlook were worrisome. How firm was the staff's projection of a sizable increase in public capital inflows in 1984? The staff had made only brief mention of the arrears to non-Paris Club creditors and to the prospects for reaching agreement on rescheduling. The matter was important, as it could influence the confidence of the banking community and its readiness to provide financial support.

Mr. Laske remarked that Zaïre had a mixed track record under previous Fund-supported programs. The present program seemed to be working much better: the measures that the authorities had planned to implement had in fact been introduced, and significant progress had been made in some important areas of the economy. Of particular importance were the reductions in the overall budget deficit and in the expansion of domestic credit. And the effects of the exchange reform implemented in September 1983 were promising.

The results in other areas had been less satisfactory, Mr. Laske commented. The external current account deficit had exceeded the program target, and additional arrears had been accumulated to creditors that were not participants in the Paris Club. In addition, overruns had recurred in certain categories of current expenditure, and the collection of import taxes and duties had continued to be difficult. More important, the strong acceleration in the rate of government spending in the final months of 1983 had created excessive liquidity which, in turn, had intensified pressure on the exchange rate and had led to the re-emergence of the parallel exchange market.

It was his understanding, Mr. Laske continued, that the nonobservance of the two monetary performance criteria in 1983 had been due merely to the correction of the monetary statistics. The proposed waiver was therefore acceptable.

Commenting on the program for 1984, Mr. Laske said that the size of the adjustment that still had to be made over the medium term was clearly shown in Tables 7 and 9. Several conclusions could be drawn from the projections. First, despite the substantial debt relief that had already been granted, and partly because of the copper price forecast, the external payments situation would remain very tight over a number of years. He wondered what effect a less optimistic assumption about the price of copper would have on the medium-term outlook for the balance of payments. Second, vigorous and sustained adjustment would be required for a number of years to achieve a fundamental improvement in the economic and financial situation. The most urgent need was to achieve a viable balance of payments position. Third, although the targets and major objectives of the program appeared to be broadly appropriate, in light of the slippages that had recently occurred in the form of unexpectedly large current expenditures, excess liquidity, and the re-emergence of the parallel exchange market, additional measures were clearly needed to achieve the program objectives. He fully agreed with the staff that, given the substantial bilateral and multilateral assistance that had already been given to Zaïre, the authorities must avoid any new slippages in the implementation of the program, and he attached great importance to the Government's statement that it would reinforce its policies to ensure that the program would be successfully implemented. Fourth, the implementation of the 1984 program would have to be closely monitored in order to detect at an early stage the need for any corrective action; the proposed additional review of the program was therefore appropriate.

The arrears registered with the Bank of Zaïre constituted a restriction on payments and transfers for current international transactions, Mr. Laske noted. It would be highly desirable to eliminate the arrears as quickly as possible, but there seemed to be no realistic alternative to approving them, at least for the immediate future. However, he lent his approval reluctantly; more rapid reduction in the arrears would help to re-establish the country's creditworthiness, which had virtually disappeared when the economy had fallen into disarray.

With respect to monetary policy, Mr. Laske said, the authorities had taken two important steps aimed at reducing the excess liquidity in the banking system. He wondered whether the proceeds of the sales of short-term treasury bills would be sterilized by the Central Bank, thereby ensuring the desirable tightening of liquidity. From page 12 of the staff report and Mr. Tshishimbi's description of the results of the first treasury bill auction, he had the strong impression that the sterilization might well be somewhat limited. As for the reserve requirement, although it was in principle 25 percent, the limit that had in fact been enforced was just 18 percent. The authorities should be encouraged to be more aggressive in the application of the reserve requirement, particularly if mopping up the excess liquidity proved to be more difficult than was expected.

During the previous discussion on Zaïre, Mr. Laske recalled, Mr. Alfidja had mentioned that his authorities were giving thought to requesting a resident representative. He wondered whether they had formed a firm view on the posting of a resident representative in Zaïre, which he himself strongly favored. Finally, the proposed decisions were acceptable.

Mr. Flamant recalled that during the discussion on Zaïre's request for an arrangement some Executive Directors had harbored doubts about the ability of Zaïre to take the needed actions. The present staff report clearly showed that the authorities had adhered to the program and had remained strongly committed to the adjustment effort. They had not hesitated to take further steps aimed at keeping the program on track despite adverse external developments.

The foreign exchange market had performed remarkably well, given its innovative character, Mr. Flamant commented. He did not fully agree with the staff that the market would function satisfactorily only if "interest rates on domestic currency deposits should be higher than interest that can be earned on foreign exchange by an equal amount at least to the expected depreciation of the exchange rate, which in turn reflects inflation differentials." In taking that view the staff had overemphasized the importance of interest rates. Whatever the level of interest rates might be, an asset denominated in zaïres could not be a perfect substitute for an asset denominated in dollars, if only because the goods that could be commanded by the two assets were not perfect substitutes. Hence, no matter what the interest rates might be, there would be an incentive to hold foreign exchange rather than domestic currency.

The 7 percent depreciation of the zaïre against the U.S. dollar in the first months of 1984 was not a cause for concern, given the unification of the exchange market on February 24, 1984 and the appreciation of the U.S. dollar against all other currencies during the same period, Mr. Flamant continued. The market had inevitably to find the proper exchange rate. The staff apparently had also provided inconsistent advice: it had first suggested that the Bank of Zaïre should sell $14 million on the free market in the period October 1983-February 1984; then, recognizing that foreign exchange reserves had been almost exhausted, it had asked the Bank of Zaïre to purchase foreign exchange on the free market in order to build up reserves.

Commenting on monetary developments, Mr. Flamant noted that the authorities were in the process of establishing a domestic money market that was to be supported by auctions of treasury bills. That innovative approach was thought to be a prerequisite for the creation of a forward exchange market, but he wondered whether the staff was not going too far too fast in encouraging the creation of new mechanisms that could prove to be somewhat sophisticated for the Zaïrian economy, which was still in an early stage of development. He also wondered whether interest rates of 45-50 percent on treasury bills might not have adverse side effects. They could entail an increase in lending rates to the private sector, which apparently had averaged 30-32 percent, and they could be a heavy burden on the budget. For example, sales of Z 500 million in treasury bills with an interest rate of 50 percent would add Z 250 million in interest charges to the budget deficit. There were other ways of reducing the excess liquidity in the banking system, for instance, by enforcing the existing reserve requirement.

The authorities had made an enormous effort to reduce the budget deficit, Mr. Flamant commented. However, the budgetary situation appeared to be extremely tight; there was no room for maneuver should slippages occur, for instance, as a result of adverse developments in the world copper market and a reduction in the amount of taxes paid by GECAMINES.

As for the evolution of the balance of payments, Mr. Flamant remarked, the fact that the copper prices assumed for the 1984 program had not materialized was certainly regrettable. The originally assumed price was \$0.79; just four months later, the estimate had been reduced to \$0.72, as the benefits of the world economic recovery clearly had not spread to all primary commodities. The expected shortfall on copper export earnings in 1984 was approximately \$71 million, the equivalent of three quarters of the increase in outstanding Fund credit to Zaïre in 1984. The difficulty of correctly forecasting the price of copper, and its overwhelming influence on export receipts, made the medium-term balance of payments outlook and the corresponding debt service projections uncertain. However, some improvement could quickly be registered if the prospects for a sizable increase in oil production and exports materialized.

The recent Paris Club meeting had been successful, Mr. Flamant commented. The arrangement ensuring regular monthly payments to a blocked account was interesting, and he wondered whether there were any precedents for it. It could have helped to avoid the recent debt-related difficulties experienced by Sudan. What progress had been made in rescheduling Zaïre's obligations to non-Paris Club members?

He was pleased that a review had been added to the program, Mr. Flamant remarked. Finally, during the previous discussion on Zaïre, his chair had raised the possibility of appointing a resident representative, and it would be useful to know whether any progress in that direction had been made.

Mr. Clark stated that the proposed decisions were acceptable. The authorities were to be commended for the substantial progress they had made in reducing the imbalances in the economy, and particularly those on the fiscal side. The adoption of a unified floating exchange rate in February 1984, and the substantial liberalization of the trade and payments system were also most welcome.

Nevertheless, Mr. Clark went on, the overall situation remained very tight. The liquidity overhang that had developed toward the end of 1984, the high level of debt and arrears, the uncertainties about commodity prices, and the very low level of reserves left no room for slippage. The program would have to be monitored closely, and the provision for an extra review was welcome. He agreed with previous speakers that posting a resident representative to Zaïre would be of substantial help in monitoring the program.

He fully endorsed the 1984 program objectives, Mr. Clark commented. It would be essential to maintain external balance and to create the conditions for the efficient functioning of the exchange rate system. As the staff's medium-term projections clearly showed, international support would be needed for some time to come. A more detailed discussion of the medium-term supply-side issues--and particularly the linkages between the objectives of Fund and World Bank involvement in Zaïre--would have been useful.

The authorities' intention of producing a definitive list of government personnel by end-May 1984 was encouraging, Mr. Clark commented. It should constitute an important step in what would have to be a continuing drive to ensure that only genuine government employees received government salaries.

As for the parastatals, Mr. Clark went on, the proposed review being made in cooperation with the World Bank, and the interim limit on subsidies, were welcome, given the recent deterioration in the parastatals' financial position. But he understood that the review would not be completed until December 1984. Meanwhile, it would be helpful to adopt other measures, for instance, to improve the financial information systems of the parastatals.

The authorities had taken a number of useful steps to absorb the excess liquidity in the banking system, Mr. Clark commented, but much higher, and positive, real interest rates would be needed to ensure their success. The staff had suggested that the new market in treasury bills, together with tighter reserve requirements on commercial banks, could push up interest rates to more remunerative levels, thereby helping to reduce the pressure on the foreign exchange market. However, the table on page 39 suggested that the rediscount rate of the Bank of Zaïre would in fact remain at 20 percent, less than half the projected rate of inflation.

The measures that had been introduced to lower tariffs were welcome, Mr. Clark remarked. Despite the initial revenue losses from them, they should make a considerable contribution to bringing trade back into regular channels, thereby helping to stamp out the parallel market. Strengthening the customs service, with technical assistance from the European Communities, also would be very helpful. He hoped that progress in those areas would be fully covered during the next review.

The staff projections showed a financing gap emerging in 1985 and highlighted the country's dependence on the level of the price of copper, Mr. Clark continued. In its next report on Zaïre, the staff should include a number of scenarios suggesting how the gap would be affected by different levels of adjustment, as had been done in the recent reports on Turkey and Yugoslavia. An indication of the effects of changes in the copper price on the projections would also be helpful.

Mr. Mtei said that he broadly agreed with the thrust of the staff appraisal. The proposed decisions were acceptable.

The authorities had made considerable progress during 1983 in reducing the domestic and external imbalances, Mr. Mtei noted. The external current account deficit had been significantly reduced as a result of the substantial debt relief obtained from Zaïre's creditors. On the budget side, all the measures in the 1983 program had been implemented, and the overall budget deficit had been reduced from 8.7 percent of GDP in 1982 to 2 percent in 1983. The effects of the devaluation, together with the introduction of a number of other measures, had resulted in a 76 percent increase in revenues despite the lower than expected revenues from certain taxes. At the same time, total expenditure had risen at a much slower pace in 1983 than in 1982, even though expenditures on services and interest on medium-term and long-term external public debt had been 8 percent higher than had been projected; that the 1984 program had taken those slippages into account was encouraging.

On the monetary side, Mr. Mtei went on, a number of difficulties had emerged, including substantial credit expansion, and a high rate of inflation due mainly to the excess liquidity in the economy. However, the 1984 program provided for the containment of overall credit expansion with a view to reducing the rate of inflation. In that connection, the authorities' decision to cut the rate of expansion in domestic credit by 50 percent was a step in the right direction.

The recent unification of the exchange rate system was welcome, Mr. Mtei said, although the parallel market appeared to continue to be active, due to the excess liquidity in the economy and the weakening of customs control. Under the 1984 program, that problem was to be dealt with partly by implementing tighter money and credit policies in order to slow the rate of depreciation of the zaïre. The authorities had already moved in that direction by limiting monetary expansion to 30 percent and by attempting to reduce the rate of inflation to less than 50 percent. A related problem, namely, the lack of incentives to hold domestic currency, was reflected in the excess demand for foreign exchange. The authorities were aware of the problem and were trying to improve the interbank foreign exchange market in order to restore equilibrium to the demand for, and supply of, foreign currency. In passing, he noted that the authorities had also encouraged interbank transactions and had reduced the incentives for speculation on the exchange rate.

The balance of payments was expected to be under intense pressure in 1984 and 1985, Mr. Mtei observed. Thereafter, the pressure was expected to ease, and equilibrium and a substantial surplus were forecast for the period 1988-90, although much would depend on developments in the world commodity markets, their effects on Zaïre's export receipts, and the extent to which Zaïre weathered the present problems without harming its growth potential.

Mr. Prowse stated that the proposed decisions were acceptable. The requested waiver was appropriate, as it was needed simply to rectify certain statistical errors.

The authorities had a remarkable record of policy adjustment and implementation, including the reduction of the external deficit, the unification of the exchange rate, and the decline in the budget deficit, Mr. Prowse remarked. Although the rate of inflation had risen to 76 percent in 1983, compared with the target of 68 percent and the actual rate of inflation in 1983 of 37 percent, and although the rate of economic growth had been less than had been hoped for, the program for 1984 seemed to be as strong as could be expected in the circumstances. He agreed with the staff that the main objectives of the program were fully appropriate, but that additional measures would be needed, particularly to mop up excess liquidity, and that an additional review under the stand-by arrangement would be helpful. The only difficulty he had with the proposals for 1984 was that the current account deficit would still be large--9.6 percent of GDP after rescheduling--at the end of the program. One might have reasonably expected the authorities to aim for a somewhat larger reduction in the deficit--particularly in the light of the medium-term projections--and he wondered what steps the authorities could feasibly take to achieve it.

The monetary and credit measures taken were appropriate, Mr. Prowse commented, but some of the staff's recommendations were not fully clear to him. The staff apparently favored positive real interest rates, but it stated on page 11 that "interest rates on domestic currency deposits should be higher than interest that can be earned on foreign exchange by an amount equal at least to the expected depreciation of the exchange rate, which in turn reflects the inflation differentials." A less complicated formula might be more useful. Were positive real interest rates feasible when the rate of inflation was 76 percent?

He fully endorsed the decision to limit the foreign exchange holdings of the commercial banks, which had reached 240 percent of the banks' assets at end-December 1983, Mr. Prowse commented. In fact, the decision should have been taken much earlier.

The medium-term projections did not include alternative projections based on various assumptions about copper prices, Mr. Prowse noted. Instead, the projections were based on the assumption that copper prices would steadily rise throughout the rest of the 1980s. A further comment on the optional policy approaches that would be appropriate if copper prices did not rise as projected would be useful.

Further debt rescheduling was likely, Mr. Prowse remarked, even on the basis of a generous assumption about copper price developments. The financing gap was expected to disappear in 1988 if copper prices behaved as expected, although different estimates of the size of that gap were given in the staff paper. Table 9 showed debt service ratios of either 42.3 percent or 49.2 percent for 1984, depending on whether or not Fund drawings were included, and a ratio of 53 percent was included for 1985. On page 40, however, a debt service ratio for 1984 of 26.9 percent was shown. Apparently the differences in the ratios were due in part to the inclusion or exclusion of actual payments. He wondered whether ratios that included actual payments should be seen in a different light from ratios that excluded such payments, and what purpose was served by excluding Fund transactions from a debt service ratio.

While the authorities had made considerable progress, Mr. Prowse remarked, credit for Zaïre's success should also be given to the country's creditors. They had shown a remarkable degree of understanding and flexibility, and he hoped that they would continue to do so in coming years.

Previous speakers had appropriately stressed the importance of the public enterprise sector, Mr. Prowse recalled. Relatively little was apparently known about the enterprises, and the proposed World Bank study on them was therefore welcome. To what extent had the authorities followed through on their commitment to pass to the private sector 31 percent of the total activity of the public enterprises? Was there any scope for shifting additional public enterprises to the private sector?

Mr. de Vries stated that the proposed decisions should be approved. The requested waiver was the result of improvements in statistics and monitoring, and he had no difficulty in accepting it.

He agreed with Mr. Leonard that, although the economy had improved considerably, a number of problems remained, Mr. de Vries said. The improved budgetary control, the monetary restraint, the reform of the exchange rate market, and the considerable depreciation of the exchange rate had been instrumental in the major improvement in the economy, but the parallel market had re-emerged, small overruns in the government sector had occurred, and there had been difficulties in collecting customs duties. Although some needed budgetary measures had been introduced, it would also be important to keep monetary developments under control.

The tax system had been improved, Mr. de Vries noted. For example, GECAMINES had begun to pay taxes. However, the Government was still not certain of the size of public sector employment; a study was expected to be completed shortly to determine its precise extent.

He agreed with Mr. Prowse's comments on the public enterprises, Mr. de Vries said. Relatively little was known about them and the World Bank study should be completed quickly. Transferring some public enterprise activities to the private sector might well be worthwhile.

Attachment I contained an impressive list of the measures that the authorities had adopted in 1983, Mr. de Vries noted, although some of them seemed to be overlapping or inconsistent. For instance, the reference to the "de jure liberalization of all domestic retail prices, implemented September 12, 1983," was not fully consistent with, or might overlap, the descriptions of "increases in petroleum retail prices, implemented September 18, 1983" and the "increase in the retail prices of diesel fuel and kerosene, implemented March 26, 1984." The reference to price liberalization did not seem to describe accurately the actual price situation.

He had been struck by the large interest payments on the public debt and by the fact that, even on the basis of relatively optimistic assumptions, the balance of payments was expected to remain under pressure for a long period, Mr. de Vries observed. That outlook underscored the need both for the drastic measures that had been introduced, and for maintaining the important adjustment effort. Still, an important start had been made, and the economic situation was quite different from the one at the time of the previous discussion on Zaïre. The authorities would have to make long-term improvements in the economy and they could not permit slippages to occur without seriously harming the economy. It would be useful to know more about their view on the posting of a resident representative to Zaïre.

Mr. Malhotra said that the proposed decisions were acceptable. The authorities had made considerable progress in their adjustment effort by reducing the budget deficit and recording notable advances in the trade and payments areas. However, the rate of inflation remained very high, and excess liquidity had been evident in the final months of 1983. The authorities should be urged to continue to pay close attention to those problems.

The staff had recommended an increase in interest rates, Mr. Malhotra noted, but in his view the main focus of policy should be on the need to reduce the rate of inflation. Indexing of interest rates to the rate of inflation might not be an appropriate policy recommendation. That was not to say that no room for change existed. Indeed, interest rates were on the low side and should certainly be reviewed.

The medium-term outlook remained a cause for concern, Mr. Malhotra said. The current account deficit of the balance of payments was expected to remain large, and debt servicing was likely to remain excessive. The level of foreign reserves was on the low side, the volume of arrears was large, and a financing gap was expected after the mid-1980s. The Fund, other multilateral institutions, and governments would probably have to continue to be involved in Zaïre for a long period.

Mr. Zhang stated that the proposed decisions should be approved. The present stand-by arrangement had become effective in December 1983, but only after the authorities had spent 12 months implementing strong measures to correct the financial and other imbalances. Those actions clearly showed the commitment and determination of the authorities to make the adjustments needed to attain a sustainable balance of payments position and positive rates of economic growth. The measures had been successful in several areas. The most important progress was the reduction of the budget deficit from 8.7 percent of GDP in 1982 to 2 percent in 1983. Considerable progress had also been made in curtailing the increase in domestic credit and in reducing the current account and overall balance of payments deficits.

When fully implemented, the policies under the 1984 program would consolidate the overall gains achieved thus far and further strengthen the adjustment in the fiscal and monetary fields, Mr. Zhang considered. He was pleased to learn from Mr. Tshishimbi's opening statement that the efforts in those fields would be supplemented by actions in the real sector. Steps were needed to reduce the distortions in the economy in general, and to remove bottlenecks in agriculture, mining, and transportation in particular, thereby providing a solid basis for the future expansion of production.

The prospects for exports were somewhat less reassuring, Mr. Zhang went on. According to the revised projections, the rate of increase in the value of exports in 1984 would be smaller than had been expected and lower than the actual rate of increase in 1983. Even more worrying was the expectation that the value of the main export, copper, would fall in 1984. Moreover, the terms of trade were also expected to deteriorate further.

It would be useful to receive a further comment on the effects of the large devaluation in 1983 on trade and the rate of inflation, Mr. Zhang commented. According to the figures on page 39, the real effective exchange rate had fallen by 23 percent in 1983, but the volume of exports had increased by only 7.9 percent, compared with a rise of 13.3 percent in 1982, when the real effective exchange rate had appreciated. The volume of imports had increased slightly in 1983, compared with a 7.8 percent fall in 1982. According to the revised projections for 1984, the rate of increase in real exports would be smaller than in 1983, but the rate of increase in real imports would be larger. Had that outcome been expected at the time of the devaluation in 1983, and what factors accounted for it? The staff had cautioned that in 1984, as in 1983, domestic inflation would cause a further depreciation of the exchange rate. Did the staff feel that that cause-and-effect relationship had actually been reversed, and that the sharp increase in consumer prices in 1983 and the expected continued rapid inflation in 1984 were the result of the large devaluation of 1983?

The Deputy Director of the African Department remarked that the increase in liquidity in 1983--and particularly in the second half of the year--had been somewhat larger than expected, for three reasons. First, the increase in net foreign liabilities had been smaller than anticipated. Second, the elimination of the resident foreign currency accounts, as required under the program, had been delayed and had occurred at a relatively more depreciated exchange rate. Third, although the budget deficit for 1983 had not been larger than had been estimated, there had been some rapid disbursements toward the end of the year, particularly to reduce internal arrears.

Commenting on the major reform effort in the final quarter of 1983, the Deputy Director said that the changes in the exchange rate and in inflationary pressure had been considerable. The price liberalization in Zaïre had been broad in comparison with similar efforts in other African countries, but some prices and tariffs remained controlled. In Zaïre, as in many other African countries, the prices of gasoline and diesel oil were controlled. The increase in the price of diesel oil had affected the retail prices of a number of commodities, particularly many food items. The tariffs on transportation had been increased sevenfold.

The staff had closely examined the interdependence of credit expansion, inflation, and the depreciation of the currency, knowing that it was essential that the exchange rate should reflect market forces, the Deputy Director explained. In that connection, the authorities had wished to reduce the rate of inflation as much as possible to avoid any kind of snowball effect. They were aware that further depreciation of the exchange rate would increase the pressure for adjustments in wages and the prices of gas and oil, and they had reacted by adopting a number of important measures.

Some of those measures were designed to soak up the excess liquidity, the Deputy Director continued. For instance, the authorities had moved fairly quickly to begin sales of treasury bills. The discussions between the staff and the authorities on the possibility of such sales had occurred in late February 1984, and the first auction had taken place in early April. Three subsequent auctions had been held, and the interest rate on the bills had ranged from 40 percent to 45 percent. It was difficult to say whether or not the rate of interest had been positive in real terms. It was impossible to forecast accurately the rate over a whole year, as much would depend on the effectiveness of the new measures. The objective with respect to interest rates was to free them so that they could be determined by market forces. At the start of the auctions, however, the authorities had fixed the treasury bill interest rate in order to provide initial guidance to the market. The net outstanding volume of treasury bills was Z 150 million.

It had been important to implement appropriate measures to eliminate the excess liquidity and to improve the functioning of the foreign exchange market, the Deputy Director went on. Indeed, some of the measures had been overdue. The authorities had acted to limit the amount of foreign exchange that banks could hold. At the same time, the exchange rate had depreciated steadily, from about Z 30 per dollar to Z 35.5 per dollar by end-March 1984. Thereafter, the exchange rate had stabilized at Z 35 per dollar. Hence, the new measures had at least arrested the constant decline in the value of the currency, something that was clearly desirable.

The question had been raised, the Deputy Director recalled, whether the expansion of credit provided for under the 1984 program was not excessively rapid. With respect to net credit to the Government, the counterpart fund for the external debt was sizable--approximately twice as large as the public sector wage bill. As for investment expenditure, the recent World Bank mission had expressed some concern about the cut under the 1984 program; the World Bank staff felt that the provision for productive investment was at the lower end of the desirable range.

Commenting on the revenue performance, the Deputy Director said that the weakness of the customs service was worrying. Steps had been taken to strengthen it, with the technical assistance of the EC. An EC expert had arrived in Kinshasa on April 18, 1984 for a one-month stay in order to suggest measures for avoiding smuggling and slippages in the collection of customs duties. The speed with which the new technical assistance scheme was implemented in Zaïre would eventually depend on how quickly the EC itself acted.

The performance of the public sector was a cause for concern, the Deputy Director commented, and the World Bank had sent a mission to assess the situation. One of the public enterprises whose financial position was particularly weak was Air Zaïre, and the authorities had approached several foreign airlines, including Swiss Air, concerning a management contract. The issue was not yet settled. The World Bank had stressed that its survey would take some time because it would entail detailed audits of a large number of the enterprises.

Commenting on the arrears to the members of the Paris Club, the Deputy Director said that an arrangement had been made under which SDR 14.25 million would be paid monthly and held in an escrow account with the Federal Reserve Board. Although there had been a slight delay, the monthly payments were current. Payments to international agencies had also been made. As for payments to governments that were not members of the Paris Club, the staff had been informed that the authorities had sent letters toward the end of February 1984 to the various creditor countries. The staff would inquire about the response to the letters during its next mission to Zaïre, in the second half of May 1984. It was important to stress that the arrangements with non-Paris Club members should be in line with the rescheduling for Paris Club members; such arrangements were often difficult to negotiate. Agreements with all the creditor countries would probably not be reached by the time of the next discussion on Zaïre; the staff would report on the progress made by then. There was still some question about the arrangements with commercial banks. Indeed, some members of the Paris Club had complained in December 1983 that the banks had been treated somewhat better than a number of the official creditors. The staff was supposed to contact the commercial banks after the next mission to Zaïre.

In December 1983, during the negotiations on the 15-month program for Zaïre, the Deputy Director recalled, performance criteria had been set only for December 1983. During the mission's visit to Zaïre in February 1984, performance criteria had been set for end-March and end-June 1984. However, indicative credit ceilings for the entire year 1984 had been set in December 1983. During the discussions with the authorities in May 1984, agreement would be reached on performance criteria for end-September and end-December 1984. The increase in net credit to Government from end-March to end-June 1984 had been very small, and the Treasury would have to keep expenditure under tight control to meet the end-June performance criterion.

The external current account deficit was larger than had been expected for the various reasons mentioned in the staff report, the Deputy Director said. The projection for the external current account in 1984 was still provisional. As for the debt service ratios, the difference in the various figures was due to an important extent to the differences in the assumptions about debt rescheduling. Even if the 1984 economic and financial program was successfully implemented, Zaïre would almost certainly have to approach the Paris Club again in 1985. However, in order not to prejudge future decisions by Zaïre's creditors, no account had been taken of further debt rescheduling in one of the calculations of the ratio, which explained the increase in the debt service ratio based on payments due. By contrast, when further debt reschedulings were assumed for 1985 and 1986 under terms similar to the reschedulings for 1984, the debt service ratio was considerably reduced. The staff had taken note of the request for alternative assumptions of the price of copper in future assessments of Zaïre's medium-term prospects.

Most international lending institutions were taking a wait-and-see attitude toward Zaïre, the Deputy Director explained. They were waiting to see whether the authorities would implement the program for 1984, and its success was therefore extremely important. The staff did not expect many potential investors to make sizable amounts of money available to Zaïre before the beginning of 1985.

The staff estimate of a 3 percent increase in imports was reasonable, the Deputy Director considered. Imports had been liberalized, and some increase in imports could therefore be safely expected.

The staff and the authorities had discussed in February 1984 the possible posting of a resident representative to Kinshasa, the Deputy Director explained. They had agreed to consider the matter further, and it was to be taken up again during the discussions in May 1984.

The volume of exports had fallen in 1980 and 1981 and had recovered in 1982, the Deputy Director said. The increase in volume in 1983 had been expected, and an even larger rise was anticipated for 1984. Of all the various sectors of the economy, the gold, diamond, and copper mines had benefited most from the depreciation of the zaïre. Their financial position had improved significantly, and increases in investment and in maintenance were expected, although the volume of production was not expected to grow for several years. As for agricultural production, the change in the exchange rate had occurred after the sowing season, and the impact of higher producer prices on output would probably not be felt for several months.

The present period was particularly difficult, the Deputy Director added, because of the lagged effect of the currency adjustment on production and the wait-and-see attitude of most potential investors. If Zaïre could succeed in adhering to the Fund-supported program through 1984, thereby restoring the confidence of various agencies and potential investors, it would have a reasonable chance of improving its balance of payments.

When the staff had asked the Bank of Zaïre to sell a minimum of $13 million in foreign exchange on the interbank market, the Deputy Director of the African Department said, it had hoped to give life to the market by supplying it with sufficient foreign exchange, and it had wished to see Zaïre make optimal use of its foreign exchange. The action had succeeded in activating the market, but during its visit to Zaïre in February 1984 the staff had been somewhat concerned by the low level of foreign exchange reserves of the Bank of Zaïre; it had felt that the authorities should have a cushion of foreign exchange while they were maintaining a floating exchange rate. In the circumstances, including the introduction of a limit on holding of foreign exchange by commercial banks, it had been appropriate for the Bank of Zaïre to purchase some foreign exchange. The Bank of Zaïre had been a net purchaser of foreign exchange, although not on a large scale, over the previous several weeks.

The staff representative from the Exchange and Trade Relations Department recalled that the question had been raised whether a gap had existed in the coverage of the performance criteria for the period December 1983-February 1984. The program had included indicative criteria for the whole year 1984. Moreover, according to the provisions of the stand-by arrangement, the purchase linked to the end-December 1983 performance criteria was not to have been made until end-February 1984. A staff mission had been in Zaïre during the two-month period of the lag in the reporting of data to discuss the next set of performance criteria.

The Paris Club had used the escrow account procedure in a number of recent cases because of delays in concluding bilateral agreements, the staff representative from the Exchange and Trade Relations Department explained.

Mr. Tshishimbi remarked that a devaluation typically had an important impact on the exports of a country like Zaïre, which had a dominant mining sector and was essentially a price taker in world markets. A devaluation also affected the manufacturing sector, which imported most of its production inputs; a devaluation usually affected companies' operating costs. In general, a devaluation was useful when it was aimed at helping to eliminate distortions in the economy.

Responding to the question on the rate of liquidity creation, Mr. Tshishimbi said that the much higher rate noted during the final two months of the year than during the ten previous months probably accounted for the very high rate for the year as a whole.

Commenting on the excess liquidity in the economy, Mr. Tshishimbi said that there had been some hoarding of currency in Zaïre. By setting up a new money market, the authorities intended to offer hoarders an opportunity to use their funds in the new market. Such efforts also aimed at forcing the commercial banks to compete for deposits.

The performance criteria for the rest of 1984 would be established during the next staff mission to Zaïre, Mr. Tshishimbi noted. As for the apparent gap in the coverage of the performance criteria, although the staff report had not contained explicit criteria for the period December 1983-February 1984, they had existed implicitly, and the authorities had been aware of the effort expected of them. The implicit criteria had been discussed informally by the staff and the authorities before the review that had been conducted in February 1984.

Air Zaïre, one of the main problems in the public enterprise sector, Mr. Tshishimbi commented, was in the process of being restructured. Although it employed some 5,000 employees, only about 750 of them were actually on the job. Discussions had been started with several foreign companies in an effort to increase the efficiency of Air Zaïre.

Negotiations between the authorities and Zaïre's commercial bank creditors had already taken place, Mr. Tshishimbi said, and the authorities would discuss the agreements with the staff during the next mission. There were still unresolved issues concerning the phasing of payments in 1984; the commercial banks and the authorities were each studying the other side's proposals. The agreements probably would be in the final stage by the time of the next staff visit to Zaïre. Multilateral institutions were the only non-Paris Club participants other than the commercial banks, and there had never been any suggestion that the debt owed to those institutions should be rescheduled. The arrears to the multilateral institutions had been eliminated, and some private financial groups that had participated in the financing of some investments in Zaïre were discussing possible rescheduling with the authorities.

His chair had not yet taken a firm view on the question of a possible resident representative for Zaïre, Mr. Tshishimbi said. The issue had been raised during the February 1984 discussion between the staff and the authorities, and the authorities were not opposed in principle to a resident representative. They intended to give the matter further thought and to raise it again during the next staff mission.

Mr. Laske commented that it was his understanding that the amount of treasury bills sold in excess of the targets for mid-1984 and end-1984 would serve to absorb liquidity available in the markets. He had understood Mr. Tshishimbi to say that the sales target had not yet been reached, and he had therefore concluded that the objective of absorbing or sterilizing liquidity had been fairly limited. The matter could be further discussed on a bilateral basis.

The Deputy Director of the African Department remarked that Mr. Laske's understanding was correct. During its last visit, the mission had noted that the budget deficit was likely to be somewhat higher than had been anticipated due to several factors, in particular higher interest payments on the foreign debt. It had been agreed to keep bank financing of the 1984 budget deficit at the original target of Z 2.6 billion, but to provide the Government with some margin for maneuver through the sale of treasury bills, which would induce the authorities to launch such sales. It had been agreed that the budget deficit could be financed by treasury bills up to Z 200 million by end-June and up to Z 500 million by end-December, without reducing the corresponding subceilings on net credit to Government.

The Chairman said that there was widespread agreement that the performance of the authorities, particularly with respect to the budget and the liberalization of the exchange and pricing systems, had been commendable. The budgetary situation would have to be closely monitored to avoid any slippage and any conflict with the credit ceilings. Monetary policy must be geared to curbing excess liquidity, which was clearly one of the main problems; permitting interest rates to rise to reflect market conditions was of paramount importance.

Considerable emphasis had been placed on the need to restore confidence, the Chairman continued, and full implementation of the program was therefore indispensable. The payment of arrears to all creditors on schedule would also be of fundamental importance in restoring confidence. The creditors had played their part, and the difference in the various debt service ratios provided an indication of the significance of the debt relief that they had provided. The creditors obviously expected Zaïre to play its part by eliminating the arrears.

The medium-term outlook, especially for external debt, remained difficult, the Chairman commented. It was therefore particularly important for Zaïre to make all the needed adjustments under the Fund-supported program. In light of the importance of Zaïre fully implementing the adjustment program, he hoped that the authorities would take note of the emphasis placed by Executive Directors on the usefulness of a resident representative.

The Executive Board then took the following decisions:

Review Under Stand-By Arrangement

1. Zaïre has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Zaïre (EBS/83/257, Supplement 2, December 22, 1983), and the letter of the President of Zaïre dated September 12, 1983 with annexed memorandum, attached to the stand-by arrangement, in order to reach understandings subject to which Zaïre may make further purchases under the stand-by arrangement. Zaïre has also requested the Fund to waive observance of the performance criteria in paragraph 4(a)(iv) and (v) of the stand-by arrangement for end-December 1983.

2. The letter of the President of Zaïre dated March 26, 1984, together with Table 1, shall be attached to the stand-by arrangement for Zaïre and the letter of September 12, 1983 with annexed memorandum shall be read as supplemented by the letter of March 26, 1984, and Table 1.

3. The Fund grants the waiver requested by Zaïre.

4. Zaïre will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Zaïre's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota

(a) during any period in which

(i) the ceilings on net domestic assets of the banking system at end-March and end-June 1984; or

(ii) the ceilings on net credit of the banking system to the Government at end-March and end-June 1984; or

(iii) the net cumulative reductions of commercial and invisible arrears through cash payments in foreign exchange by end-March and end-June 1984

specified in Table 1 attached to the letter of March 26, 1984 are not observed; or

(b) if the reviews with the Fund relating to the third and fourth purchases under the stand-by arrangement, which are to be conducted not later than end-July and end-October 1984 respectively, have not taken place, or while the performance criteria adopted as a result of these reviews are not being observed.

5. Paragraph 4(c) of the stand-by arrangement for Zaïre in EBS/83/257, Supplement 1, December 22, 1983, shall be amended to read as follows:

(c) during the entire period of this stand-by arrangement while Zaïre has any overdue financial obligation to the Fund, or if Zaïre:

(i) imposes or intensifies restrictions on payments and tranfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

Decision No. 7682-(84/68), adopted
April 30, 1984

Exchange System

1. Pending the completion of bilateral arrangements for the rescheduling or refinancing of Zaïre's external debt, the Fund grants approval of the restriction on payments and transfers for current international transactions that is evidenced by payments arrears.

Decision No. 7683-(84/68), adopted April 30, 1984

2. SUDAN - REQUEST FOR STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a request from Sudan for a one-year stand-by arrangement in an amount of SDR 90 million, or 53 percent of Sudan's quota (EBS/84/83, 4/11/84; and Sup. 1, 4/23/84).

The staff representative from the Middle Eastern Department made the following statement:

The staff would like to inform the Executive Directors of a number of new factors and developments:

1. The estimate of the unfinanced gap in the balance of payments of US$650 million in 1984 presented in the staff report is based on an estimated official transfers level of US$435 million. This projection reflects the pledges of assistance made at the December 1983 meeting of the Consultative Group, as well as the assumption that disbursements in 1984 from the donors who did not indicate specific commitments at the Consultative Group would be maintained at their 1983 level. Last week the staff was advised by the Sudanese authorities that there might be a significant shortfall from the assumed aid level, but that the matter was being pursued further. Additionally, the staff has recently learned that there may be difficulties in setting up the proposed oil financing arrangement, which, by saving on expenditure for petroleum imports, was expected to reduce the financing gap; it is possible that the modalities of the arrangement may not be agreed upon by the end of May 1984. As Directors know, the proposed decision on the stand-by arrangement sets a deadline of May 31, 1984 for the finalization of arrangements to cover the gap. The developments just mentioned, if not reversed, would significantly widen the gap to be covered through domestic policy measures. In the staff's judgment, it is unlikely that the Sudanese authorities would be able to formulate and implement, by the end of May 1984, a set of domestic measures that would compensate for the widened gap resulting from these new developments.

2. The staff has pointed out in the report that, after recording growth of less than 5 percent in the first four months of 1983/84, the money supply growth accelerated in November and December. However, the latest data indicate a marked slowdown in the rate of monetary expansion in January and February 1984. As a result, domestic liquidity has increased by about 15 percent in the first eight months of 1983/84. The staff believes that, in view of the expected seasonal slackening of demand for credit in the remaining months of the year, the program target of an 18 percent increase in domestic liquidity in 1983/84 is attainable.

3. The staff report has expressed a concern that continuation of civil disturbances in the southern region of Sudan and the uncertainty created by the process of Islamization may adversely affect the program. There are recent indications that the Government is moving further in the enforcement of Islamic practices and regulations. For example, recently the corporate form of business organization was abolished and it was announced that the operating commercial banks would soon directly participate in business ventures rather than extend credit. Moreover, the disturbances in the South have resulted in an indefinite cessation of work on the two major development projects, namely, the construction of the oil pipeline and the Jonglei Canal to divert the Nile River. As indicated in the staff report, these matters will be discussed with the authorities in June, but the staff is concerned about the uncertainties that they have created about economic developments in 1984/85.

Continuing, the staff representative from the Middle Eastern Department commented that the staff reports indicated that the authorities were committed to enlarging the scope of the free foreign exchange market and to taking steps to enable banks and foreign exchange dealers to set rates in line with the underlying forces of supply and demand. Those steps would result in an effective depreciation of the Sudanese pound and in a reduction in the weight of the official market that would constitute a further step toward unification of the exchange rates. The authorities and the staff had reached firm understandings on the nature and timing of the relevant adjustments, but in view of the sensitivity of the matters, the authorities had not wished to include them in their letter of intent. The actions were an integral part of the June 1984 review, on which further purchases were dependent, and detailed information on them would be reported to the Executive Board in due course.

Mr. de Vries commented that the opening statement by the staff representative, and particularly the third paragraph, introduced great uncertainty about likely developments in the coming period. What did management expect the Fund, in effect, to say to the members of the Paris Club?

The Chairman commented that the Executive Directors were being asked to adopt a decision on the quality of the design of Sudan's program. The stand-by arrangement would not actually become effective until the Fund found that satisfactory arrangements had been made to finance the uncovered gap in Sudan's balance of payments in 1984. The staff had suggested that the deadline for making such arrangements should be May 31, 1984. If the staff believed that, in the period before May 31, 1984, fundamental changes had made it impossible for the authorities to achieve the program objectives and to adhere to the performance criteria, it would bring the matter to the attention of the Executive Board. In effect, in accepting the proposed decision the Executive Board would be informing the financial community and the Sudanese authorities that the Fund accepted the design of the country's program and was willing to support it, although it could actually become effective only when the financing gap had been closed as a result of actions by Sudan's creditors. Meanwhile, the Fund would continue to watch closely the conditions in which the program itself would be implemented. Postponing the adoption of the proposed decision would send the wrong signal; it would indicate that the Fund did not approve of the new program. The Fund could approve the stand-by arrangement "in principle" and, if the financing gap was closed and the authorities provided assurance that they would maintain appropriate policies, the proposed stand-by arrangement could become effective.

Mr. Nimatallah said that he strongly agreed with the Chairman. The Executive Board should adopt the proposed decision forthwith and encourage the authorities to arrange to cover the financing gap by May 31, 1984.

In its opening statement, Mr. Nimatallah noted, the staff had mentioned that there might be difficulties in closing the financing gap and in setting up the proposed oil financing arrangement which, by saving on expenditure for petroleum imports, was expected to reduce the financing gap. The staff had noted the various amounts of assistance that had been provided to Sudan by Saudi Arabia in recent years. However, the staff had not taken into account that in 1984 Saudi Arabia had committed an additional $75 million in development aid to Sudan under the three-year Investment Program agreed with the World Bank. The Sudanese authorities should be able to take advantage of that assistance in 1984, during the new program period. The additional assistance from Saudi Arabia should reduce the uncertainty about the closing of the financing gap. In addition, it was his understanding that the Sudanese authorities were proceeding to establish a petroleum fund in cooperation with certain donors, and particularly the United States and Saudi Arabia. The Saudi Arabian authorities expected that the Sudanese authorities would proceed with the project on schedule, thereby helping to close the financing gap.

Mr. Mtei made the following statement:

> The Sudanese authorities appreciate the help they have received from the staff in formulating an economic program to be implemented in 1984 as part of their continuing adjustment

efforts. They are grateful to the Fund for the constructive role it has played in providing Sudan with both technical and financial assistance, and hope that this close cooperation will continue in the future.

Performance under the last stand-by arrangement, which ended last March, was mixed. On the positive side, the budget deficit relative to GDP was reduced further in 1982/83, from 8.9 percent in the previous fiscal year to 6.1 percent, which is 1 percentage point lower than the program target and contrasts markedly with a deficit/GDP ratio of 9.8 percent just two years earlier. As a result, domestic bank financing of the budget was held well below the program ceiling. Activity in the real sector, however, fell below expectations. Although there was considerable expansion in agricultural output in irrigated areas in response to increased production incentives to farmers, this was not enough to offset the impact of drought conditions on rain-fed agriculture and the sluggish performance of the manufacturing sector due to power shortages, inadequate supplies of raw materials and spare parts, and the continued emigration of skilled labor. Consequently, real GDP declined by 2.7 percent, whereas the program had projected a growth rate of 3.5 percent. Inflationary pressures also intensified, and the external payments position remained weak.

The Sudanese authorities remain aware of the fact that these problems are in large measure structural in nature and therefore require sustained efforts within a medium-term framework. The program before the Executive Board today should be seen in this context; it represents a continuation of the Government's efforts to lay the foundation for sustained economic growth and financial stability. The policies under the proposed program have been formulated with a view to expanding agricultural production and agrorelated manufacturing activities, containing inflation, and alleviating pressures on the country's balance of payments position. It is important to note that the realization of these objectives will depend on Fund assistance being complemented by support from other multilateral institutions such as the World Bank, as well as donor countries and the international banking community.

Reflecting the priority being given to the agricultural sector, a number of steps have been taken recently within the context of the structural adjustment program supported by the World Bank to increase output. These include, among others: (a) increasing procurement prices of export commodities by amounts ranging from 23 percent to 45 percent; (b) expanding acreage under cotton and groundnut cultivation by 12 percent; (c) ensuring timely availability of essential production inputs; (d) channeling capital resources and basic inputs to the more productive agricultural projects; and (e) continuing the rehabilitation of the capital stock and the institutional reform of financial relations in the irrigated schemes. With regard to the manufacturing sector, the producer price for sugar has been increased, financial incentives for textile producers have been improved, and steps have been taken to increase the availability of spare parts and basic inputs. With these measures in place, together with the efforts being made to improve the transport system and to enlarge the electric power generation capacity, it is projected that real GDP will grow by about 5.5 percent in 1983/84.

The overall budget deficit in 1983/84 is projected at 6.7 percent of GDP, compared with 6.1 percent in 1982/83, despite an increase in interest payments on external public debt of about 1 percent of GDP. To prevent a more serious erosion in the Government's financial position, new taxes had to be introduced along with cutbacks in expenditure. The sale of government securities to the nonbanking sector was also expanded. The authorities are aware that the pressure on the budget is serious and are therefore continuing their efforts with technical assistance from the Fund to enhance expenditure control. They also intend to implement a major fiscal reform by introducing a new tax system, the "Zakat," which has its roots in Islamic fiscal practices aimed at broaden ing the tax base. It is expected that the budget deficit relative to GDP will be reduced further in 1984/85.

The objective of monetary policy is to limit the growth in domestic liquidity to 18 percent in 1983/84, paving the way for further reduction in 1984/85 which will ensure growth in money supply of no more than 12 percent. Bank credit to the Central Government in 1983/84 will be restricted to less than 1 percent of GDP. The dependence of public entities on bank financing is also expected to be reduced, reflecting an improved financial situation resulting from increased production and a more rational price structure. In order to contain credit expansion to the private sector in 1983/84, the authorities have, among other steps, raised the reserve deposit ratio and instituted selective credit control.

The authorities recognize that interest rates could play a catalytic role in mobilizing domestic resources and in rationalizing credit allocation. However, the use of such a policy instrument is not compatible with the Islamization process of the banking sector that is now taking place. Hence, other alternatives based on the principle of sharing profit and losses are being considered. The authorities hope to learn from the experience of a number of noninterest banks already in operation, and progress in this area will be discussed with the staff during the review mission.

The exchange rate policy now in place seeks to maintain an adequate return to exporters and to ensure the evolution of a free exchange market. A staff study of Sudan's exchange system in 1983 shows that it provides sufficient incentives to producers of export commodities, especially cotton. Private exchange dealers have recently been licensed to operate along with commercial banks in an effort to strengthen the foreign exchange market and widen its scope. The authorities do not intend to interfere in the functioning of the market or to regulate prevailing rates. The unification of the exchange rates remains the goal of economic policy. However, the authorities, for practical reasons, prefer to follow a more gradual approach toward this objective.

Export performance improved considerably in 1983, and a further growth of 8 percent is projected in 1984. Despite the projected improvement in the trade balance in 1984, the balance of payments position of Sudan remains fundamentally weak. The main problem is the burden of servicing the country's large external debt, which has created a financing gap of about $650 million, even after Sudan has received pledges of $489 million in cash and commodity aid at the Consultative Group meeting last December. However, this gap is expected to be financed mainly through debt rescheduling, the mobilization of additional external assistance, and the establishment of a special fund to finance oil imports. Early this month, a debt relief arrangement was accepted by the major commercial banks. In the next few days, and depending on the outcome of today's Executive Board discussion, the Paris Club is expected to consider Sudan's request for debt rescheduling. The Sudanese authorities have emphasized their intention to approach all their bilateral creditors for debt relief arrangement on the same terms and conditions provided by the Paris Club. Because of the very high debt service ratio, the authorities intend to continue their policy of refraining from nonconcessional borrowing, a policy that is consistent with other efforts being made to reduce the debt burden.

The Sudanese authorities are determined to continue with the difficult adjustment process and to implement the necessary measures required to restore equilibrium in the economy. However, in view of the country's extremely difficult external payments position, sizable external assistance and exceptional debt relief will be necessary over a number of years. Continued Fund support is also indispensable. The program Executive Directors have before them today is a reflection of the authorities' determination to improve Sudan's economy and deserves the Board's support.

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

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Caranicas upon the completion of his service on the Executive Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/67 (4/26/84) and EBM/84/68 (4/30/84).

4. MALAYSIA - TECHNICAL ASSISTANCE

In response to a request by the Malaysian authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/84/124 (4/23/84).

Adopted April 27, 1984

5. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the GATT consultations with Hungary, India, Israel, and Yugoslavia to be held in Geneva, as set forth in EBD/84/122 (4/23/84).

Adopted April 27, 1984

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/33, Supplement 1 (4/25/84) and EBAP/84/84 (4/26/84) is approved.

APPROVED: October 9, 1984

LEO VAN HOUTVEN
Secretary