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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/174

10:00 a.m., December 16, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
J. de Groote	
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
	T. Yamashita
	Jaafar A.
	L. Leonard
	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	
	E. A. Ajayi, Temporary
M. A. Senior	
J. Tvedt	A. Lindø
	T. A. Clark
Zhang Z.	Wang E.

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

Also Present

African Department: O. B. Makalou, Deputy Director; N. Abu-zobaa, E. L. Bornemann, E. A. Calamitsis, A. Jbili, I. Kapur, M. E. Massourakis, B. R. H. S. Rajcoomar, M. Sidibé, A. C. Woodward. Asian Department: I.-S. Kim, K. Saito. Central Banking Department: P. Duvaux. European Department: J. J. Hauvonen. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; E. B. Maciejewski. External Relations Department: H. O. Hartmann. Fiscal Affairs Department: J. C. Tavares. Legal Department: Ph. Lachman, S. A. Silard. Middle Eastern Department: F. Drees. Research Department: W. C. Hood, Economic Counsellor and Director; K.-Y. Chu, N. M. Kaibni, A. Salehizadeh, H. H. Zee. Treasurer's Department: W. L. Coats, Jr., D. S. Cutler, D. Gupta, Q. Md. Hafiz, A. F. Moustapha, M. Sami, T. M. Tran. Western Hemisphere Department: J. Ferrân. Bureau of Statistics: J. B. Gupta. 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, L. K. Doe, S. El-Khouri, K. A. Hansen, W. Moerke, Y. Okubo, I. R. Panday, P. D. Péroz, D. I. S. Shaw. Assistants to Executive Directors: E. M. Ainley, J. Bulloch, M. Camara, M. B. Chatah, L. E. J. M. Coene, R. J. J. Costa, M. Eran, G. Ercel, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, J. K. Orleans-Lindsay, G. W. K. Pickering, M. Rasyid, A. A. Scholten, Shao Z., S. Sornyanyontr, P. Verly, J. C. Williams, A. Yasseri.

1. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR DECEMBER 1983-FEBRUARY 1984

The Executive Directors considered the designation plan for December 1983-February 1984 (EBS/83/258, 12/2/83) and the operational budget for December 1983-February 1984 (EBS/83/259, 12/2/83).

The staff representative from the Treasurer's Department explained that there had been further use of currency of about SDR 100 million under the currency budget. An amended table showing how the budget had been executed would be circulated soon. In some recent operational budgets and designation plans the staff had drawn attention to the discussions between the Bureau of Statistics and the United Arab Emirates on the definition of reserve data for the International Financial Statistics. An agreement had recently been reached between the Bureau and the United Arab Emirates, and the new data had been supplied to the Bureau. On the basis of that data, the staff had recalculated the proposed budget and plan; in each case, the staff had suggested that the figure for the United Arab Emirates be reduced by a specified amount, and that the totals should be reduced by the same amount. Accordingly, in Table 1 of the budget, the figure for transfers via the United Arab Emirates would be reduced from SDR 23.2 million to SDR 14 million, and the figure for the country in Table 1 of the designation plan would be reduced from SDR 29.6 million to SDR 16.3 million.

Mr. Erb said that he could go along with both the proposed budget and the designation plan. On page 6 of the operational budget, in the discussion on consultations with, and concurrence of, members in the use of their currencies, it was stated that "to the extent that members' currencies might be used in those transactions and operations for which members' concurrence in the use of their currencies is required, it is proposed that--as with previous budgets--the discussion of the budget by the Executive Board will be considered to constitute the necessary consultations. On this occasion, this procedure would also cover the use of currencies in asset payments for quota increases." His authorities had no difficulty in accepting that interpretation, but they would like to be informed of the magnitudes that might be involved. The staff could usefully estimate the use of U.S. dollars in the payment of quota subscriptions.

His authorities were pleased, Mr. Erb continued, that the current negotiations with industrial countries and Saudi Arabia on further borrowing by the Fund were proceeding well and would probably be concluded soon. He had been struck by the words of a European central banker quoted in a recent newspaper article: "You cannot expect the Europeans and Japan to finance the IMF indefinitely without the United States--it would be unthinkable." Bearing that statement in mind, Executive Directors could usefully examine the proposed designation plan, which showed that the reserve position of the United States in the Fund had grown from SDR 4,342 million at the end of 1981 to SDR 9,019 million at the end of October 1983, a significant increase that included both ordinary resources and $1.5 billion in borrowed resources for the supplementary financing facility. Significant use of U.S. dollars in drawings on the Fund was likely in 1984, and a further sizable increase in the reserve position of the United States in the Fund would probably occur. It should be clearly understood, therefore, that the United States was providing large-scale resources to the Fund, and rightly so, given the strength of the U.S. dollar. It was informative to note that the reserve position of many other countries had not increased during the past few years. The reserve position of Germany and Japan had risen, and the position of Saudi Arabia had increased from SDR 3,428 million at end-1981 to SDR 7,915 million at end-October 1983, largely as a result of Saudi Arabia's loan for the enlarged access policy.

Mr. Grosche said that the proposed decisions were acceptable. He had consistently maintained that member countries should provide appropriate data on foreign reserves on a timely basis, and the provision of recent data on the reserves of the United Arab Emirates was certainly welcome.

The staff representative from the Treasurer's Department explained that, so far, the staff had received indications from member countries of their intention to use about U.S. dollar equivalent to SDR 300-350 million in payment of the asset portion of their quota increases. That amount was covered by the SDR 420 million for the United States in the proposed budget. The staff had received indications from all but a few countries on how the payments would be made.

The Executive Board then took the following decisions: 1/

SDR Department - Designation Plan for December 1983-February 1984

The Executive Board approves the designation plan for the quarterly period beginning December 16, 1983 as set out in EBS/83/258 (12/2/83).

Decision No. 7580-(83/174) S, adopted
December 16, 1983

Operational Budget for December 1983-February 1984

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/83/259, page 4, footnote 1, and the operational budget for the quarterly period beginning December 16, 1983, as set out in EBS/83/259 (12/2/83).

Decision No. 7581-(83/174), adopted
December 16, 1983

1/ Amended Table 1 of the operational budget for December 1983-February 1984 and a table updating all use of currencies and SDRs under the operational budget for September-November 1983 appeared in EBS/83/259, Supplement 1 (12/16/83).

2. ZAIRE - 1983 ARTICLE IV CONSULTATION, AND REQUEST FOR STAND-BY ARRANGEMENT; AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1983 Article IV consultation with Zaïre, a request by Zaïre for a 15-month stand-by arrangement equivalent to SDR 228 million (EBS/83/257, 11/30/83), together with a request by Zaïre for a purchase equivalent to SDR 114.5 million under the compensatory financing facility (EBS/83/260, 12/1/83; and Sup. 1, 12/15/83). They also had before them a report on recent economic developments in Zaïre (SM/83/248, 12/9/83).

The staff representative from the African Department said that on December 12, 1983 Zaïre had paid in full the amount of its quota increase. As a result, on the basis of calculations in accordance with the provisions for the use of ordinary and borrowed funds contained in paragraph 8 of the decision on enlarged access, the arrangement with Zaïre could be financed with SDR 5.7 million more in ordinary resources than was indicated in EBS/83/257. A revised stand-by arrangement noting the correct mix of resources would be issued in due course.

Mr. Alfidja made the following statement:

> A brief summary of the main macroeconomic developments during 1980-82 is necessary in order to place the present requests for a stand-by arrangement and a drawing under the compensatory financing facility in a proper perspective.
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> The overall economic activity in Zaïre was depressed in 1982 as real GDP fell by 1 percent following two years of stagnant growth--of about 2 percent--mainly reflecting fluctuations in the output and export of mineral products. Technical difficulties and transportation bottlenecks as well as shortages of spare parts and raw materials were the main contributory factors to the decline in the production of cobalt and the stagnation of copper output, while the recession in the industrial countries exerted a dampening effect on demand for those products. The external position deteriorated markedly in 1981 when the current account deficit increased to 8 percent of GDP from 3 percent in 1980, owing mainly to lower export receipts. A small improvement occurred in 1982 when the current account deficit declined to 7 percent of GDP, as a result of a marginal increase in exports and slightly lower imports. The capital account deteriorated quite substantially in 1981 and remained under pressure in the following year. Similarly, during 1980-82, the fiscal situation worsened as the overall balance of government financial operations moved from an equilibrium position in 1980 to a deficit of 6 percent of GDP in 1981 and 9 percent of GDP in 1982, owing not only to higher outlays but also to a slower growth in revenue. The expansion of net domestic credit accelerated to 54 percent in 1981 and 77 percent in 1982, up from 45 percent in 1980,

largely on account of the government sector demand. The inflation rate, as measured by the GDP deflator, declined by 17 percent between 1980 and 1981 to 34 percent and edged up to 37 percent in 1982.

These developments occurred in the context of the economic and financial policies undertaken by the Government in support of which the Fund approved an 18-month stand-by arrangement covering the period July 1979-December 1980, and a three-year extended arrangement covering the period 1981-83. At the initial stages of the latter arrangement, implementation was in the right direction but as the international economic environment worsened and domestic demand management proved difficult, Zaïre's economic and financial situation began to deteriorate further; when it became evident that the objectives of the program could not be fully attained the arrangement had to be canceled in June 1982. However, the authorities continued, in close cooperation with the Fund, to explore various policy options to deal more effectively with the problems that had emerged, keeping in mind the constructive comments made by Directors at previous Board discussions on Zaïre's problems.

In late 1982 and early 1983 the authorities took a number of corrective measures that focused principally on the budget, following which they adopted a comprehensive adjustment program for 1983-84. The basic objectives of this adjustment program are to make substantial progress toward the attainment of a viable balance of payments position over the medium term, to reduce the budget deficit, to restrain monetary expansion, and to contain the rate of inflation--thus laying the foundation for a gradual revival of the economy.

The principal element of the program is the far-reaching exchange rate action that was introduced in September 1983, which involved a 77.5 percent devaluation of the zaïre in terms of the SDR. This was coupled with the exchange rate reform establishing a floating exchange rate regime based on an interbank foreign exchange market for freely determining the exchange rate of the currency. In furthering the new exchange rate policy, the authorities have taken strong measures to liberalize and simplify the exchange and trade arrangements. In September 1983, they abolished the 30 percent foreign exchange surrender requirement by the commercial banks to the Bank of Zaïre, the resident foreign currency accounts, and most export retention quotas. Furthermore, commercial banks may now freely allocate 75 percent of their retained earnings to their customers. With regard to imports, the old system that allowed financing without recourse to the banking system's foreign exchange resources has been eliminated, and the licensing regulations have been rationalized by bringing a limited number of nonessential imports under the prior authorization category.

In 1983 and 1984, Zaïre's external sector position is expected to show some improvement as the current account deficit is forecast to decline from SDR 340 million in 1982 to SDR 240 million in 1983 and to SDR 230 million the following year. Similarly, the overall balance of payments deficit is projected to fall gradually from nearly SDR 600 million in 1982 to SDR 400 million in 1984. This overall outlook reflects projected large amortization payments of the external debt, which outpace medium-term and long-term capital inflows. The Government of Zaïre is hopeful that the forthcoming debt relief negotiations with its foreign creditors will permit the gathering of the necessary financial assistance in support of the adjustment effort under way.

In the fiscal area, the authorities have implemented the recommendations of the joint Fund/Bank technical assistance mission and they intend to implement additional measures in 1984 with the aim of reducing the budget deficit from about 9 percent of GDP in 1982 to about 2 percent in 1983, and to eliminate it in 1984. Reflecting the impact of the devaluation and the new measures, revenue is projected to increase faster than expenditure. The revenue increase is largely attributable to the rise in the contributions to be made by GECAMINES, payroll taxes, and taxes on goods and services arising from greater efforts at collection and further tightening of enforcement of the turnover tax. Budgetary controls would continue to be tight through the centralization of all government operations under a single ministry. Quarterly targets have been established for the key expenditure categories of school teachers' salary payments, outlays of the presidency and the political institutions, and for total expenditure. The commitment of my authorities to pursue tight fiscal and incomes policies is evidenced by their decision to allow only a moderate increase in nominal wages, resulting in further reduction in real incomes. The authorities have ensured that the local currency equivalent of debt service obligations are available when they fall due, and for this purpose a blocked account has been established at the central bank exclusively for debt servicing.

In support of the fiscal and incomes policies described above, the authorities intend to reduce the growth in liquidity to about 52 percent in 1983 and 35 percent in 1984, through a slowdown in credit to the Government. My authorities have recognized the need to provide the private sector with sufficient access to domestic credit in order to promote economic recovery. Under the program, therefore, increased credit will be channeled to the private sector in order to reverse the trend of the past few years. As for interest rates, the central bank rediscount rate was increased in September 1983 by 5 percentage points, and the rate on advances to the Treasury was also raised by 4 percentage points. The central bank also liberalized commercial bank lending rates, and rates for the noncoffee agricultural sector have been unified at 15 percent in order to encourage the development of this key sector of the economy. The authorities intend to keep the interest rate policy under constant review.

The liberalization of the domestic pricing system, which began in 1981, has been continued; and the administrative circulars that were issued in September 1983 lifting price control procedures and practices now have the force of law. The retail prices of petroleum products have been adjusted to pass through fully the impact of the exchange rate action, and there is no budget subsidy on these products.

The implementation of all the measures described above is expected to reduce the large distortions in the economy, promote exports and import-substituting industries, and ensure that the exchange rate system effectively responds to market forces. Furthermore, the measures are expected to discourage parallel market activities and foster budgetary discipline. It is worth emphasizing that my authorities are fully aware that despite the progress made in recent months, the renewed adjustment efforts will have to be sufficiently vigorous and sustained since Zaïre still faces serious bottlenecks that continue to retard the development of the agricultural, mining, and transportation sectors. In spite of the willingness and commitment of my authorities, the economic policies would have a reasonable chance of success only if supported by external financial resources. It is therefore their expectation that the economic and financial policies that they intend to implement for the rest of 1983 and in 1984, as outlined in the policy memorandum attached to the staff paper, and under which they have already introduced the key elements, would generate the necessary confidence in the economy and convince Zaïre's creditors and donors, as well as investors, about the crucial importance of foreign financing to support the country's adjustment and development efforts.

Regarding the request for a purchase under the compensatory financing facility, the analysis provided by the staff in EBS/83/260 indicates that Zaïre's payments position continues to be very difficult and that its balance of payments need justifies the request. Moreover, since the authorities have adopted and are implementing a comprehensive adjustment program, the cooperation requirement should be regarded as having been met. It is also their intention, to continue to cooperate with the Fund in efforts to find appropriate solutions to the country's balance of payments difficulties.

I strongly urge my colleagues to accede to my authorities' requests for a stand-by arrangement and a drawing under the compensatory financing facility. I also recommend the proposed decisions in EBS/83/257 for approval by the Board.

Mr. Nimatallah noted that nearly two years had passed since the previous Article IV consultation with Zaïre, and Executive Directors and their authorities were therefore out of touch with developments in the country. He had expected the 1983 Article IV consultation to be discussed by the Executive Board before any requests from the country to use the Fund's resources, thereby permitting Executive Directors to reassess Zaïre's policies and provide important guidance to staff and management in their negotiations with the authorities. Instead, the Executive Board had been given only two weeks to consider three substantive papers on the complex case of Zaïre. The problems facing Zaïre were serious, mainly because of the country's own actions, and Zaïre's track record with the Fund was poor. Management had had sufficient time to consider Zaïre's request, but the Executive Board had been given very little time to fulfill its responsibilities. It was not clear to him why the request for a stand-by arrangement and a purchase under the compensatory financing facility had been hastily added to the agenda.

The problem that he had raised was particularly significant in the light of recent developments in Zaïre, Mr. Nimatallah went on. Zaïre had consistently maintained inadequate and inappropriate policies against the advice of the Fund. His chair had expressed grave doubts about the decision in mid-1981 approving the extended arrangement for Zaïre, and the doubts had been quickly confirmed, as the authorities had failed to meet the conditions under the arrangement almost from the outset. The arrangement had been canceled after one year, because it had been impossible to bring the program back on track. In addition, Zaïre had not honored its debt service obligations to the international financial community. It had continued to accumulate arrears, and on several occasions it had fallen behind in its repayments to the Fund.

It was against that unsatisfactory background that the Executive Board was being asked to approve a new stand-by arrangement and a drawing under the compensatory financing facility, Mr. Nimatallah said. The request involved a substantial amount of Fund resources, much of which would be disbursed at an early stage. What had happened in Zaïre to persuade staff and management that the country's performance would be better under the proposed arrangement than it had been under previous arrangements? What evidence was there that the authorities were able and willing to implement a program and bring the economy back on track? He doubted whether the needed changes had been made.

The Government had continued to provide unreliable data to the Fund, Mr. Nimatallah went on. A Fund-supported program could only be as good as the data on which it was based. According to his own authorities, Zaïre's arrears to Saudi Arabia were larger than the Zaïrian authorities had reported to the staff. That incorrect information shed doubt on the overall reliability of the data provided by the Zaïrian authorities. The Government's decision to roll back some of the domestic petroleum price increases introduced in September 1983, and the recent changes in custom duties that had resulted in a net revenue loss to the Treasury also shed doubt on the authorities' intentions under the new program.

He had serious reservations about the program, particularly in four areas: wage policy, the operations of the public enterprises, the accumulation of arrears, and the financing of the balance of payments gaps, Mr. Nimatallah said. The staff had reported that the proposed program was designed to control inflation through a prudent wage policy. In fact, however, the wage policy covered only wage increases in the government sector; it did not cover wage settlements in either the public enterprises or the private sector, where the authorities were merely urging wage restraint. The staff's statement that there were "pressures from trade unions to avoid further reductions in real incomes" was worrying.

There was considerable uncertainty, Mr. Nimatallah noted, whether there would be a reasonable decline in real personal incomes. If Zaïre, or any other heavily indebted country, was to be able to repay its debts, there would have to be a reduction in real incomes, and resources would have to be reallocated to productive sectors. The achievement of a reduction in real incomes required a statutory incomes policy, like the one recently introduced in Brazil. He wondered why the Fund had not asked Zaïre to introduce the same incomes policy that Brazil had recently been required to adopt. Both countries faced relatively large debts and high rates of inflation.

He did not agree with the staff, Mr. Nimatallah continued, that the Government's decision to limit the increase in its wage bill to 40 percent in 1983-84 was prudent. Incomes policies should be designed to reallocate resources and to help reduce the rate of inflation. A 20 percent increase in wages had already been granted in Zaïre, and another 20 percent wage rise was scheduled to be granted in only six months. Those increases would not help to achieve the objectives of resource reallocation and inflation control. The second wage increase should be delayed until the end of 1984 and should be linked to the rate of inflation at that time.

He was worried about the public enterprises in Zaïre, Mr. Nimatallah remarked. The number of enterprises--some 50--was large and, with few exceptions, their economic performance had been weak. The enterprises constituted a drain on the budget, and in the light of the serious fiscal situation, there was an urgent need to improve the organization and management of the public enterprise sector and to strengthen its financial position. The staff reports contained little, if any, information about the public enterprises, and the proposed program included only a few specific suggestions for reforming them. The lack of commitment in the public enterprise sector was inconsistent with the objectives of fiscal restraint and sound adjustment and was in marked contrast with the provisions under other Fund-supported programs.

An important principle for Fund-supported programs was that existing arrears should be eliminated and new arrears should be avoided, Mr. Nimatallah noted. There was no evidence in the proposed program that the principle would be adhered to. Commercial arrears at end-June 1983 had totaled more than SDR 200 million, but the proposed program merely stipulated that the arrears should be reduced by SDR 50 million by the end of the program period; nothing was said about the elimination of the rest of the arrears. Similarly, the program mentioned that all or part of the arrears to Paris Club participants were to be rescheduled, but it made no mention of other official creditors and multilateral organizations, like the Arab Bank for Economic Development in Africa and the OPEC Fund. How and when would Zaïre eliminate the arrears owed to those agencies and governments? The staff papers stated that Zaïre would approach the London Club to reschedule debt, but they made no mention of the bank creditors that were not members of that Club.

In sum, Mr. Nimatallah went on, there was no assurance that the arrears would be eliminated or even phased down, or that creditors would receive uniform treatment. Could management give him that assurance? Furthermore, in paragraph 24 of the letter of intent, the authorities undertook not to accumulate further external arrears during the program period. It was his understanding that any further accumulation of arrears to any creditor would constitute nonobservance of a performance criterion, something that would interrupt the country's right to make further purchases under the arrangement. Could management confirm that understanding?

The staff paper clearly showed that, even if the proposed program was successful, Zaïre would continue to face sizable balance of payments financing problems over the rest of the 1980s, Mr. Nimatallah observed. It was not clear to him that even on the basis of the most favorable assumptions, Zaïre would be able to meet its heavy repurchase obligations to the Fund. Moreover, given the enormous problems facing Zaïre, the country might well have to use substantial amounts of Fund resources for the rest of the decade. Hence, he wondered why the Fund was proposing to offer such a large volume of resources at a single stroke.

Because the compensatory financing was for an amount in excess of 50 percent of quota, Mr. Nimatallah said, Zaïre was required to maintain close cooperation with the Fund, and there was to be confidence that the adjustment program would be implemented successfully. In his view, however, the requirement of cooperation had not been met, and he saw no reason why the country should be entitled to make a drawing under the compensatory financing facility in excess of 50 percent of quota. In sum, he had grave doubts about the authorities' commitment to adjust, the adjustment program, and Zaïre's ability to repay the Fund. He could not support either of the two requests for the use of Fund resources, unless his doubts were allayed.

Mr. de Maulde commented that Executive Directors had not had an opportunity to discuss the economic and financial situation in Zaïre for a long time--nearly 21 months. In effect, the adjustment effort covered two years--1983 and 1984--as the first measures had been adopted in late 1982, and the program formally covered 15 months, beginning in October 1983. Indeed, the bulk of the adjustment measures had already been in place for several months and the main adjustment effort had taken place in 1983, when the overall government deficit had been reduced from 11.6 percent of GDP to 4.5 percent of GDP; few industrial countries could claim to have done as well. That substantial decline was evidence of the extent of the adjustment effort in Zaïre. Given the large adjustment that had already been made, it was understandable that the reduction in the budget deficit in 1984, although large, would be less sizable than in 1983. In addition, a major effort had been made in the exchange rate area, as the authorities had not hesitated to devalue the currency by 445 percent in local currency terms.

The problems facing the economy were admittedly due in part to inappropriate domestic policies, Mr. de Maulde said, but adverse external developments--and particularly the severe deterioration in the terms of trade since 1975--had played an important role. A fall of 1 cent per pound in the price of copper involved an annual loss of $11 million in export revenues for Zaïre. If the average price for copper in the period up to 1981 had prevailed in 1982 and 1983, when the actual price had fallen to $0.66 and $0.73 per pound, Zaïre's export receipts would have been $1.2 billion larger than had actually been the case; that amount was broadly equivalent to the external payment arrears at end-June 1983 and was more than three times the amount that the Fund would provide under the proposed decisions. Adverse external developments had clearly played a prominent role in the slippages that had taken the economy off track and had caused the extended arrangement approved in 1981 to fail. In any event, it was important to remember that that arrangement had followed a successful one-year stand-by arrangement implemented in 1980. The marked decline in the international price of copper had reduced both foreign exchange earnings and government revenues and had therefore been a key factor in the large increase in the budget deficit, which, in turn, had rekindled inflation and caused sizable cost-price distortions. In the absence of a flexible exchange rate policy, the most damaging of the distortions had been in the exchange rate area. The overvaluation of the exchange rate had led to black market operations and the development of a parallel economy that had added to the distortions.

The proposed program adequately addressed the internal causes of the economic and financial imbalances, Mr. de Maulde remarked. It was clearly designed to end the price distortions and the overvaluation of the exchange rate. The new interbank foreign exchange market system, established after the large devaluation of September 1983, was the centerpiece of the adjustment program. It was an imaginative mechanism and the only one of its kind in Africa, and there was widespread agreement that it had been functioning satisfactorily. The new exchange rate policy would undoubtedly be beneficial in a number of ways, for instance, by causing an increase in import customs duties that would help to reduce further the budget deficit in the coming year. It should also encourage a renewal of agricultural exports, which would in turn support the needed diversification of the export base.

The comprehensive price liberalization had permitted the passing through of the price effects of the devaluation even on such sensitive items as petroleum products, Mr. de Maulde continued. Hence, the whole spectrum of prices could again play a useful role in resource allocation and had already begun to spark a revival of economic activity. Recent developments clearly indicated the importance of relative prices, but correct prices alone were not a sufficient condition to ensure the proper allocation of resources. A recent report prepared by the Ministry of Agriculture for the Consultative Group for Zaïre, showed that there was still a number of infrastructure bottlenecks, especially in the transport sector. The World Bank had a major role to play in helping Zaïre to eliminate the bottlenecks, and a further comment on the cooperation between the Fund and the World Bank in ensuring the success of Zaïre's adjustment effort would be useful.

The authorities were to be commended for having been patient and for deciding to implement a shadow program in preparation for the Executive Board's consideration of the proposed program, Mr. de Maulde remarked. The authorities had received no financial support from the Fund during the full year of the shadow program. To his knowledge, it was the first time that such a procedure had been used, and he wondered whether management felt that the case of Zaïre set a precedent for the use of that approach to similar cases in the future? If that proved to be the case, he would have to express some reservations about such a procedure, since the Fund already had a useful mechanism, namely, the application of performance criteria, to ensure that its resources were not disbursed before certain conditions had been met by the borrowing country.

That the proposed stand-by arrangement had been limited to 78 percent of Zaïre's new quota for what was in effect a two-year program--or 39 percent of quota a year--was extremely surprising given the strength of the Government's adjustment effort and the large balance of payments need, Mr. de Maulde continued. The financing gap was SDR 368 million in 1983 and SDR 353 million in 1984. The proposed decisions were not fully consistent with the established principles governing the use of Fund resources, especially as, excluding the drawing under the compensatory financing facility, the Fund's holdings of zaïres would amount to only 144 percent of Zaïre's new quota by end-March 1985, leaving a large margin for possible future drawings even on the basis of the new access limits. Indeed, it seemed fair to ask whether the principle of uniform treatment of members would be adhered to with the acceptance of the proposed decisions. In August 1983 the Executive Board had given Ghana maximum access to the Fund's resources under a one-year stand-by arrangement together with a purchase equivalent to 76 percent of quota under the compensatory financing facility on the grounds that the country "had adopted a comprehensive program of adjustment with major measures already in place." The same could be said of Zaïre, which had already introduced important measures. Moreover, Zaïre's case seemed to be similar to the recent cases of Ecuador and Uruguay, and he looked forward to hearing comments from the staff on the question of equality of treatment.

The proposed program, Mr. de Maulde considered, contained elements that seemed to ensure its success in the absence of unfavorable factors beyond the control of the authorities. The price of copper had declined during the previous weeks, and he hoped that the world economic recovery would gather sufficient momentum to bring it back up, in line with the staff's assumption for 1984, to $0.79 per pound. The increase would be particularly welcome in the light of the continued substantial financing gaps that were likely in coming years. The outcome of the forthcoming meeting of the Paris Club and the Consultative Group would be of crucial importance. In the light of the difficulties that could arise if the assumptions behind the program were not borne out in fact, it might be helpful to appoint a resident representative to provide for continuous monitoring of the program. Finally, the proposed decisions should be approved.

Mr. Erb considered that it was useful to examine the proposed decisions in the context of Zaïre's performance under previous Fund-supported programs. The stand-by arrangement for 1976-77 and the extended arrangement approved in 1981 had been canceled, mainly because the ceilings on net credit to the Government had been exceeded. The adoption of Fund-supported programs for Zaïre had been accompanied by debt relief granted by the Paris Club in nearly every year since 1976. The external payments pressures had admittedly been intensified by the precipitous decline in Zaïre's terms of trade since 1975, mainly because of the fall in copper prices. Nevertheless, the inability to sustain an adjustment effort and the tendency to maintain the pace of a questionable domestic investment program even when it had to be supported by foreign borrowing on hard commercial terms had been the main causes of the deterioration in Zaïre's economic performance.

Despite the official and multilateral assistance that it had been given, Mr. Erb noted, Zaïre had accumulated significant payments arrears that would have to be dealt with. Given the Fund's disappointing experience with Zaïre, management and staff had acted correctly in waiting for some time to bring the proposed program to the Executive Board and in requiring the kinds of adjustment policies that had been implemented during the previous year. The Government would certainly have to follow through on the adjustment effort during the coming year, and it was on that assumption that he broadly agreed with the staff appraisal and could support the proposed decisions.

The goals and major objectives of the proposed program were appropriate, Mr. Erb continued. The efforts that the authorities had been making were correct, given the magnitude of the needed adjustments. The authorities would have to implement the proposed program vigorously. He attached particular importance to their commitment in the letter of intent to take any further measures beyond those contained in the policy memorandum that might be needed to achieve the program objectives. The authorities correctly recognized that the implementation of the program would require strong and sustained domestic efforts.

The inflation target for 1984 of 47 percent was high, Mr. Erb commented. The authorities should attach considerable importance to reducing the rate during 1984 and, particularly, in the following period. The adjustments of the exchange rate and domestic prices would of course have an adverse effect on the rate of inflation in the short run, but it would certainly be important to control inflation over time.

The centerpiece of the proposed program was the exchange reform, which had begun on September 12, 1983 with the devaluation of the zaïre, Mr. Erb noted. He was pleased that since October 17, 1983 the rate of depreciation of the official exchange rate had exceeded that of the free rate. The authorities should be encouraged to unify the exchange rate as soon as possible, preferably before the target date.

The measures introduced during the previous two years to liberalize domestic prices were welcome, Mr. Erb said. The renewed commitment--evidenced by a law introduced on September 12, 1983--to increase the use of the market mechanism in the allocation of resources was welcome, although he had some questions about the effect of ex post price controls. As he understood it, private enterprises were required to operate on the basis of invisible pricing guidelines, something that undoubtedly inhibited the growth of the private sector because of the adverse effect on investment decisions within the sector. The elimination of the government subsidies for petroleum, public utilities, and domestic public transportation had clearly been necessary, but the transfers and subsidies still accounted for 7 percent of current expenditure in 1983 and 1984. What plans did the authorities have to reduce them in the near term?

The projected reduction in the budget deficit from 8.7 percent of GDP in 1982 to 1.9 percent of GDP in 1983 was a clear indication of the strength of Zaïre's adjustment effort, Mr. Erb remarked. It would be critically important for the authorities to achieve the fiscal objectives in the program period and beyond. In their policy memorandum the authorities had explained that they had set a limit on budget expenditure through December 1983. Such an approach would also be warranted for 1984, and he wondered whether the staff intended to seek similar limits for that year during the scheduled review in February 1984.

The credit and monetary policies seemed broadly appropriate, Mr. Erb continued, although, on the basis of the present assumption concerning inflation, interest rates would remain negative in real terms over the program period. The authorities should be encouraged to adopt a more flexible and market-related interest rate policy that would provide positive real rates of interest. Moreover, the Fund should focus on the institutional arrangements in Zaïre for collecting and allocating savings and should encourage as rapid and broad a development of the system of financial intermediation as possible.

The small increase in gross reserves--especially in comparison with the volume of Fund resources to be used under the stand-by arrangement--was worrying, Mr. Erb said. A larger increase seemed necessary to provide a meaningful short-run liquidity cushion in the event that some of the assumptions behind the program for 1984 proved to be inaccurate. A cushion had proved to be one of the most important elements of recent

Fund-supported programs in other countries. Any follow-on program for Zaïre should focus on an increase in gross reserves. Such an increase should be a primary objective for the authorities in any event, and particularly if developments in 1984 were more favorable than expected.

The staff's medium-term projections indicated that it expected a substantial financing gap through 1988; continued adjustment by Zaïre would therefore be necessary, Mr. Erb observed. Emphasis would have to be placed on sources of financing that were consistent with Zaïre's longer-term structural needs and its requirement of appropriate debt relief. The staff had projected a steady rise in copper prices through 1989, an appropriate assumption for the kind of simulation that the staff had performed. However, at some stage in the future, the staff should make a simulation that took into account the possibility of fluctuations in the price of copper; the price had in fact fluctuated considerably in the past. The exercise would of course be artificial to some extent, as the precise timing of the fluctuations could not be known in advance, but it would suggest problems that Zaïre might face in 1984 and beyond and would help the Fund in its evaluation of the country's adjustment need. What steps were the authorities likely to take if copper prices were better than was expected? The staff should discuss that contingency with the authorities to be certain that they would not respond with an immediate large increase in domestic expenditures rather than an increase in reserves and more effective restructuring of the external debt. The authorities should also be asked how they would respond to less favorable international prices than were currently anticipated. It was in that kind of situation that the Fund had an important financing role to play. The Fund should be in a position to assist a country that had to deal with such fluctuations in its external position. In many cases, the proper response by the authorities would be to introduce the kind of fundamental policy adjustments that had been introduced in Zaïre.

He had wondered why the size of the proposed stand-by arrangement was so large, Mr. Erb commented, particularly in the light of the Fund's past experience with Zaïre, the size of Zaïre's required balance of payments adjustment, the length of the expected adjustment, and the uncertainties surrounding it. In those circumstances, the Fund had to be particularly careful in committing its resources so that it could be in a position to assist Zaïre if developments turned out to be less favorable than expected. The adjustment period for Zaïre obviously would be fairly long. The Government's implementation of policies during the previous year was a good counterbalance to its earlier behavior, but a further comment on the reasons why the staff had proposed such a large stand-by arrangement would be helpful.

He continued to believe, Mr. Erb remarked, that when there was a long period between the previous and current Article IV consultations with a member, the staff report for the latest consultation should be discussed before a program that was to be supported by the Fund. Although he had been willing to go along with the discussion of Zaïre's new program after a period of less than the four weeks that Executive Directors were usually given to study staff papers, he continued to prefer to have the full four-week period.

Commenting on the proposed purchase under the compensatory financing facility, Mr. Erb said that he did not strongly disagree with the staff that past exchange rate policy had had an insignificant effect on the export shortfall, although somewhat more extensive analysis of the matter would have been useful. He had made the same point in a number of earlier cases. However, the staff should have made an adjustment to take into account the effect of Zaïre's pricing policies on the cobalt market. The sharp increases in cobalt prices in 1979 and 1980 had been due in part to the growing external demand, but also to the sharp increase in Zaïre's inventories and the reduction in Zaïre's cobalt exports. The increase in inventories had had a technical impact on the shortfall in two ways. First, it had raised the level of exports in the first year--namely, 1981--of the shortfall. Second, as a result, the shortfall in the following years had been particularly sharp.

There had been considerable discussion in the Executive Board on the extent to which an export shortfall should be thought to be beyond the control of the authorities when their pricing policies had been inappropriate, Mr. Erb recalled. In the case of Zaïre, a downward adjustment in the proposed purchase would have been warranted. Indeed, such an adjustment was particularly important in the present case because Zaïre's proposed purchase was equal to the export shortfall. He had less difficulty in accepting compensatory financing for a country in a situation like that of Zaïre when the export shortfall was larger than the proposed drawing.

He supported the proposed stand-by arrangement, Mr. Erb commented, and, with one qualification, he could go along with the proposed purchase under the compensatory financing facility. In future, the staff should take into account the impact of a government's pricing policies throughout the whole period concerned in deciding whether or not the export shortfall in the shortfall period had been caused by factors beyond the control of the authorities. The Zaïrian authorities clearly had a long way to go in their adjustment effort. They would need to continue to make steady and major adjustments in their policies in the coming years.

Mr. Leonard said that Zaïre had faced serious economic and financial difficulties for nearly a decade. He broadly agreed with the thrust of the staff analysis. The staff reports were particularly useful because of the clear explanation of the extent to which the deterioration and imbalances in the economy were attributable to factors beyond the authorities' control as well as to inappropriate domestic economic and financial policies.

For several reasons, Mr. Leonard went on, he, like some previous speakers, was concerned about the Fund supporting another arrangement with Zaïre. After all, the authorities had failed to follow through under the

1981 extended arrangement with the adjustment that they had initiated under the stand-by arrangement approved in 1979. In addition, Zaïre's economic performance had seriously deteriorated during the entire period in which it had made almost continuous use of Fund resources. Article V, Section 4 permitted waivers of conditions under stand-by arrangements only for members "with a record of avoiding large or continuous use of the Fund's general resources." In addition, such a waiver required the Fund to "take into consideration periodic or exceptional requirements of the member requesting the waiver." Under the proposed stand-by arrangement, performance criteria for the important credit variables had been set for the period only through end-1983. A further comment on that approach would be helpful.

The proposed program, Mr. Leonard continued, was both comprehensive and ambitious, and it would succeed only if external creditors made generous and, indeed, unprecedented assistance available to fill the financing gap. Past decisions by the authorities had considerably eroded international confidence, and any further deviations from sound economic and financial practices could have enormously adverse effects on Zaïre's future adjustment efforts. Zaïre faced a long and difficult road to economic recovery. A sustainable balance of payments position could only be achieved in five or six years and would be dependent upon sustained and appropriate economic adjustment and good export growth, substantial and prolonged debt rescheduling, and considerable concessional assistance. Some of those conditions could only be met if there was an appreciable recovery in the growth of world trade.

He agreed with the staff, Mr. Leonard stated, that the centerpiece of the adjustment program was the far-reaching exchange rate reform initiated in September 1983. The reform was a major undertaking that, if implemented resolutely, would go a long way toward reducing the large distortions, disincentives, and parallel market activities. In addition, it would encourage the growth of the productive sectors of the economy and, in time, would foster direct investment in those sectors from both internal and external sources. One of the most attractive features of the new system was the permanent flexibility that it ensured. The implementation of a unified system by the end of February 1984 was a welcome commitment. He looked forward to a comprehensive assessment of developments in the exchange rate area during the first scheduled review under the proposed stand-by arrangement.

He wondered whether official transactions involving both receipts and expenditures would be restricted to the official market or, in the event of an excess of expenditures, whether the Bank of Zaïre could obtain foreign exchange on the free market, Mr. Leonard said. The determination of the free rate by the commercial banks was to be made on a weekly basis, and further information on the nature of the envisaged consultation by the banks with the Bank of Zaïre would be helpful.

The proposed strengthening of the budgetary process, building on the progress that had already been made in 1983, would be an important companion to the exchange rate measures, Mr. Leonard considered. In particular, he supported the continuation of the system of monthly lump-sum payments of teachers' salaries, and the establishment of ceilings on key expenditure categories, including "the presidency and the political institutions," for which major budgetary overruns had occurred in the past. He looked forward to hearing the response to Mr. Erb's comments on subsidies.

Externally, Mr. Leonard remarked, the need to fill a large financing gap through 1988 would pose a difficult challenge to the authorities in the immediate future and beyond. As for rescheduling, he felt that a substantial rescheduling of arrears and current maturities--indeed, nearly 100 percent effective rescheduling, as in the case of Sudan--was needed for 1983 and 1984. He agreed with Mr. Nimatallah that creditors other than those in the Paris and London Clubs must be given comparable treatment, and that the rescheduled maturities should be kept relatively short, because of the sizable amounts of previously rescheduled debt that would have to be rescheduled again.

The substantial liberalization of the domestic price system was welcome, Mr. Leonard commented. There was a clear need for prudence in wages and salaries in the government sector, particularly as the price effects of the devaluation were passed on through the economy. In addition, the containment of monetary growth was appropriate, although some interest rates were still negative in real terms and should be increased.

While he had serious concerns about the proposed program, Mr. Leonard remarked, the authorities had gone a long way toward allaying them through prior actions and by designing and beginning to implement a comprehensive set of measures for 1984. The measures that the Government had introduced were important, particularly those dealing with the exchange rate, price controls, and government expenditure and revenues. The review under the stand-by arrangement scheduled to be completed before the end of February 1984 presumably would include a description of the extent to which the financing gap for 1984 had been filled. In those circumstances, he could go along with the proposed stand-by arrangement.

The export shortfall had been due mainly to price factors and therefore had been largely beyond the control of the authorities, Mr. Leonard said. However, the overvaluation of the exchange rate during the shortfall period seemed to have contributed to the reduction in exports of precious metals and diamonds. The levels of both had been below expectations. The shortfall request related to a shortfall year ended March 1983, which implied a data lag of several months. If the timeliness of export statistics was indicative of the timeliness of statistics in general, there seemed to be a need to improve Zaïre's data system, and to that end Fund technical assistance might be helpful. The export shortfall underscored the need to diversify exports. Zaïre's export earnings during the previous 11 years had obviously been volatile, which helped to explain the country's use of the compensatory financing facility in 1972, 1976, 1977, 1982, and, if the present request was approved, in 1983.

Mr. Salehkhou said that the repeated failure of adjustment programs in Zaïre was due to a number of factors, including an adverse exogenous environment and half-hearted domestic policy measures, especially on the fiscal front. The staff attached much greater significance to the inappropriate domestic policies than to the external factors.

Except for a brief period in 1980, Mr. Salehkhou continued, Zaïre's economic performance since 1975 had been characterized by recurrent crises, inappropriate domestic measures, and incomplete adjustment efforts, and it was difficult to feel fully confident about the outlook for Zaïre's economy under the proposed stand-by arrangement. Much would depend not only on the overall framework and design of the program, but also on the seriousness of the authorities' intention to implement the program. Past experience suggested that Zaïre needed to implement adjustment measures vigorously and on a sustained basis. On page 39 of EBS/83/257, the staff had carefully and prudently stated that "when fully implemented, this reform would help reduce the large distortions in the economy." On the same page the staff concluded that, given past experience, it would be essential to maintain a firm lid on budgetary outlays as a condition for maximizing the gains from the exchange reform.

The design of the program, particularly the parts dealing with budgetary and credit performance, was sound, and achievement of the program objectives would certainly yield positive results in the medium term, Mr. Salehkhou observed. Without a firm commitment, the experience of the past was likely to be repeated in the coming period. The recent substantial devaluation would only prove effective if sustained efforts were made to prevent increases in wages and prices from eroding the gains of the exchange rate adjustment. The importance of that point was underscored by the experience with previous devaluations in Zaïre.

The substantial financing gaps in 1983 and 1984 were a cause for concern, Mr. Salehkhou stated. The balance of payments projections for the coming five years were based on optimistic assumptions, such as a 10 percent average annual increase in export earnings, a 6 percent annual increase in the volume of copper exports, gradual increases in export values of cobalt, gold and diamonds, and further diversification of agricultural production. Even on the basis of such optimistic assumptions, a viable balance of payments position would take six years to attain. The preponderance of unfavorable factors at the present stage was too serious to ignore.

Mr. Finaish commented that 21 months had passed since the previous consultation with Zaïre, which had covered developments in 1981. In the relatively long period since then, the Executive Board had received little direct information about the economic and financial difficulties that had caused the cancellation in mid-1982 of the extended arrangement for Zaïre. That development was in itself a signal of the emerging "acute crisis" that the staff had described and should have constituted a strong case for an early discussion of the staff report for the 1983 Article IV consultation with Zaïre. In the light of the serious financial difficulties facing Zaïre and the country's failure to undertake appropriate adjustment policies in the past, the staff's recommendation for holding the next consultation on the standard 12-month cycle was justified.

An important economic feature of Zaïre, Mr. Finaish continued, was its impressive endowment of natural resources and its considerable potential for development. In fact, that potential was an important factor on which creditors and providers of development assistance had, for a while, based their confidence. The size and diversity of external flows from various countries and institutions were reflected in the magnitude and composition of Zaïre's external debt. Despite the country's large resource base and the availability of international finance, the economy had been moving from one crisis to another over the past several years, and Zaïre had accumulated a poor record of performance under previous Fund-supported programs, mainly because of economic and financial mismanagement.

The mismanagement had clearly been an important factor in the deterioration of the budgetary position, which in turn had been a major source of the crises, Mr. Finaish said. Together with exogenous factors, it had caused an alarming rate of growth in Zaïre's debt service payment arrears which, in turn, had inevitably caused a marked slowdown in official loan commitments, reflecting creditors' changed perceptions of Zaïre's creditworthiness. The poor performance under previous Fund-supported programs had also cast serious doubt on the authorities' commitment to introduce needed adjustment policies.

The deterioration in Zaïre's financial position had occurred despite the expansion of the country's crude oil output and exports since the mid-1970s, Mr. Finaish noted. Such a development would normally have been expected to help ease the pressures on the external accounts, particularly at a time when world oil prices had either been stable or had been pulled upward by international demand. Unfortunately the expansion of oil output in Zaïre had been overshadowed by the rapid deterioration in other sectors of the economy.

Commenting on the pace and focus of adjustment under the proposed program, Mr. Finaish said that the stated objective was to reduce the external current account deficit from SDR 340 million in 1982 to SDR 240 million in 1983 and SDR 230 million in 1984. He doubted whether, as the staff had indicated in its appraisal, a reduction in the deficit of less than 5 percent during the main period of the program could generally be categorized as a major effort toward achieving a viable balance of payments position over the medium term.

The program properly emphasized the need to improve the budgetary performance through greater fiscal discipline, Mr. Finaish continued. One of the aims of the program was to move the budgetary position from a deficit to a moderate surplus in 1984. However, when the recent large devaluation of the zaïre was taken into account, total expenditures were expected to increase by 34 percent in 1983 compared with 1982, and by a further 66.5 percent in 1984. The bulk of the increase in both years was due to current expenditure. Moreover, the budget deficit envisaged for 1983 was relatively large, particularly in comparison with the actual surplus in the first half of 1983 indicated by the provisional data on page 14 of EBS/83/257. Even if the exchange rate adjustment was taken into account, it was not clear to him whether the target for the deficit of more than Z 1 billion in 1983 was justified.

It was particularly important for Zaïre, where there was little room for maneuver, to achieve the maximum possible restraint under the proposed program, Mr. Finaish went on. The presidency and the political institutions were expected to continue to represent a relatively important share of current expenditures despite the planned reduction in absolute terms. In fact, the outlays under those categories were equal to the interest payments on the country's total debt during the first six months of 1983 and, under the program, were to be almost twice the budgeted amount for 1983 as a whole. Those facts were bound to raise questions about the authorities' commitment to badly needed economic reform.

Commenting on the assumptions behind the proposed program, Mr. Finaish noted that the staff papers had rightly emphasized the sensitivity of the program to developments in the world market for copper, Zaïre's main export commodity. The staff expected an improvement in the export performance mainly through an increase in export earnings resulting from an 8 percent rise in copper prices in 1983-84. While there was no reason to challenge that assumption, it was useful to recall that a similar assumption made in connection with Zaïre's request for compensatory financing in early 1982 had proved inaccurate. During the Executive Board's discussion on that request, some speakers had observed that, if the price projections were on the high side, they could cause the authorities to make incorrect decisions on the budget. One speaker had suggested that, given the economic situation in Zaïre, conservative estimates would have been more prudent, a view that had been confirmed by actual developments. It would be useful to know the type and strength of the additional corrective measures that might have to be introduced if copper prices increased more slowly than was assumed in the proposed program.

In order to strengthen budgetary control, Mr. Finaish observed, the proposed program included quarterly targets on key expenditure categories. Apparently the adoption of targets for the payment of specific amounts for external debt service and nondebt arrears was a useful way of helping to restore creditors' confidence and to encourage capital inflows. The program was designed to achieve a reduction in the commercial and invisible arrears of SDR 50 million by 1984, compared with total outstanding arrears of SDR 200 million. The reduction represented only about 1 percent of estimated payments on imports and services in 1983 and 1984, and he wondered whether it could not have been larger.

The proposed stand-by arrangement was the equivalent of 100 percent of Zaïre's present quota, Mr. Finaish said. If the amount of the stand-by arrangement was fully utilized and the proposed purchase under the compensatory financing facility was made, the Fund's holdings of Zaïre's currency subject to repurchase would increase to 280.7 percent of present quota. Moreover, Zaïre's external debt service projections for the medium term clearly showed that, even after excluding obligations to the Fund, the country's debt service ratio would remain at no less than 15 percent by the end of the 1980s; it was already about 39 percent. The staff could usefully comment further on the factors that it had taken into account in determining the proposed access for Zaïre, including Zaïre's ability to make the scheduled repurchases.

As the staff had stressed, Mr. Finaish remarked, the success of Zaïre's adjustment effort in the medium run would depend on a number of crucial factors, including the restoration of external confidence in the economy. The authorities' failure to respond to the rapid deterioration of the country's finances in the past had inevitably raised serious doubts about their ability and willingness to undertake the urgently needed reforms. Those doubts had been compounded by Zaïre's failure to meet its debt obligations to many countries, including the United Arab Emirates and Kuwait. Zaïre had also failed to meet its debt obligations to a number of regional development organizations, including the Arab Bank for Economic Development in Africa, and the OPEC Special Fund, in which a number of the countries in his constituency were participants. Zaïre's debt service arrears to those organizations were larger than the figures that the authorities had given to the staff.

If Zaïre was to succeed in its adjustment efforts in the medium run, Mr. Finaish went on, it would have to give priority to settling its financial obligations to its creditors and it would have to treat the various creditors equally. That conclusion was particularly important in the light of the large financing gaps that would have to be covered in the coming two years. It was important to note that Zaïre's failure to meet its debt obligations could affect other countries as well, especially with respect to the attitude of regional development organizations. In those organizations the failure of one country to service or repay its debt reduced the organizations' ability to provide badly needed development loans to other member countries. Hence, it was important for the Fund to stress to the Zaïrian authorities the need for them to act quickly in the debt area, both in the context of Zaïre's use of Fund resources and in the framework of its debt renegotiations. The principle of uniform treatment of all creditors should be adhered to in any renegotiations.

He had a number of reservations about Zaïre's request for a stand-by arrangement, Mr. Finaish continued. Moreover, the early scheduling of the discussion on the request had left Executive Directors' authorities insufficient time to study the relevant papers. In the light of those facts, he had great difficulty in supporting the proposed decisions.

Mr. de Groote commented that, because of Zaïre's position in Central Africa, its rich natural resource base, and the publicity given to the problems facing its economy, the outcome of the negotiations between the staff and the authorities would undoubtedly draw considerable attention. The strength of the program that had already been implemented in 1983, without financial support from the Fund, clearly demonstrated that the authorities had the will to introduce the needed policies for the sake of adjustment itself, and not merely as a means of obtaining Fund assistance. That point should be clearly stressed from the outset, as it had occasionally been implied that Zaïre's willingness to implement Fund-supported programs tended to end as soon as financial resources had been made available. Management had rendered Zaïre a great service by pressing for the implementation of a shadow program for a full calendar year, and the authorities had clearly shown that they had the determination and the courage needed to implement precisely the kind of program that qualified for Fund assistance. It was particularly important to note that three months had elapsed since the devaluation and the adoption of the new exchange regime, and that Zaïre had been able to withstand that shock even in the absence of new external assistance.

Zaïre's successful implementation of a program that had been proposed and approved, but not financed, by the Fund, over a long "test period" had restored the country's credibility, Mr. de Groote said. That major achievement should dispel the doubts about Zaïre that had been validly entertained a year ago, after the previous program had been canceled. During the year-long probationary period, Zaïre's economic policies had taken a decisive turn for the better in the area of resource allocation: most prices had been liberalized; the free exchange rate system had been extended to a larger number of export goods; production had been reoriented toward the agricultural sector, in line with the World Bank's recommendations; and market mechanisms had been introduced for the production and sales of mining products. The budget, traditionally the main internal source of imbalance in the economy, had registered a small surplus during the first six months of 1983, the latest period for which current statistics were available. Moreover, there had been a rapid expansion in exports of the commodities that had been submitted to the free exchange rate system.

The direction and magnitude of the changes in 1983 led to two important conclusions, Mr. de Groote went on. First, the economy had remained very responsive to market-oriented adjustment policies, indeed, more so than the most optimistic forecasts, despite the highly unfavorable world market conditions. Second, the authorities had shown that they were fully committed to a fundamental reorganization of the economy and were thoroughly aware that it would require a continuous effort over a long period. Their attitude, even more than the content of the proposed program, warranted the Executive Board's full confidence that the performance criteria for the next 15 months would be observed.

Building on the achievements of the 1983 shadow program, Mr. de Groote remarked, the comprehensive adjustment program for 1983-85 focused on the three main areas where fundamental reforms were needed, namely, the exchange system, the budget, and the development strategy. After the recent exchange rate adjustment--one of the most important in the history of the Fund--most payments were made on the basis of the free market rate, and imports had been fully liberalized, thereby removing the most important obstacle to rational resource allocation. The achievement of a balanced budget in 1984, following a deficit of about 9 percent of GDP in 1982, was an important adjustment in itself. Its importance was even more apparent when it was seen that for revenues to increase faster than expenditures, broad money would have to increase at a rate substantially slower than the prospective rate of increase in nominal GDP, and there would have to be a marked reduction in the monetary funding of the public sector. Those developments would enable credit to be rechanneled to the private sector.

The crowding out of the private sector had been thought to be one of the most unfavorable features of the economy, Mr. de Groote went on, and its reversal paved the way for a recovery of manufacturing. The new development strategy, to be submitted in the coming week to the Consultative Group, would establish a better balance between the investment efforts in agriculture, mining, and transportation. The priority that was being given to transportation was especially welcome, as bottlenecks still existed to the movement of mineral and agricultural products. He was glad that, after the important income reductions during the previous year, the proposed program provided for a global readjustment that would limit real income decreases to sustainable levels, something that seemed fully consistent with the Fund's view on adjustment.

The main reason why the development strategy should encourage a recovery--provided the external financing requirement was met--was that the present policies, unlike the previous ones, did not rely on intervention in either the price system or foreign exchange allocation, Mr. de Groote remarked. Accordingly, the economy should be able to function with as little government intervention as possible. That the economy would be able to run on the impetus of its own dynamism was already visible in the areas and sectors in which small- and medium-scale enterprises had been able to expand. The effects of the dynamism in the private sector, however, seemed to have been inadequately reflected in the real income statistics, which were based on poor price indices that to some extent incorporated expatriate consumption patterns of the past. Priority should be given to developing a proper consumer price index for both Kinshasa and the countryside.

While the overall orientation of the proposed program was correct, Mr. de Groote commented, he had questions about some of the specific objectives. The magnitude of the adjustment of the exchange rate, together with the liberalization of imports and the elimination of price controls and subsidies, were bound to cause variations in prices that would be difficult to forecast. The reaction of prices to the 1967 adjustment, which had been comparable in magnitude and had been accompanied by supporting measures similar to the newly proposed ones, suggested that the rate of inflation would slow following an initial upsurge as a result of the liberalization of imports. Some observers, however, believed that prices were likely to continue rising steeply in 1984, in which event the 40 percent ceiling on wage increases over a two-year period would be excessively rigid.

Ideally, Mr. de Groote went on, the authorities should continue to adjust the nominal wage level in response to the actual movement of prices, thereby maintaining an approximately constant margin between prices and nominal wages, which would be consistent with the desired reduction in consumers' real income. In practice, however, such a procedure could not be used because of the poor quality of the consumer price index, and the staff had had no choice but to use the more rudimentary target contained in the proposed program. It would be more realistic to decide that, if wages had to be increased more than was foreseen in response to price increases that were higher than expected, that deviation should not be seen as an indication of unsatisfactory performance, but rather as a clear sign of the need for the program to be adapted whenever necessary to changes in certain broad variables that were largely unpredictable.

Similarly, a realistic approach was needed to the budget deficit, Mr. de Groote commented, especially as net credit from the banking system to the economy--a major factor in the potential for economic expansion--was both a domestic policy target and a performance criterion. The restrictiveness of the credit ceilings became clear when comparing the permissible expansion of domestic credit under the present program with the level in December 1981, when the extended arrangement had been interrupted. Expressed in SDRs--in order to reflect the movement in approximately real terms--the level of net domestic assets of the banking system at end-December 1983 would likely be some 40 percent less than the level at end-December 1981, an exceptionally large contraction, particularly in the light of the desired economic recovery. One positive element was that the 32 percent contraction of credit to the private sector in December 1981-December 1983 had not been as severe as the contraction of net credit to the Government--44 percent. Still, he was worried that the contractionary trend of credit to the economy was expected to continue in 1984, assuming that the zaïre depreciated further in parallel with the expected movement in the rate of inflation. In that event, the net domestic assets of the banking sector would be 5 percent lower at end-December 1984 than it had been at end-December 1983.

In appealing for a realistic approach to Zaïre's adjustment program Mr. de Groote said, he wished to draw attention to the dangers of an excessively rigid attitude toward the observance of some of the performance criteria. An unexpectedly rapid expansion in economic activity could force the authorities to choose between breaching the performance criteria or slowing the expansion. The Executive Directors should therefore be prepared to consider adapting the performance criteria in a constructive manner, so that an ongoing recovery of economic activity would not be cut short because the Fund was insufficiently flexible, and required members to adhere too rigidly to performance criteria. That the proposed program provided for a re-examination of its basic assumptions on the occasion of each of the scheduled reviews was welcome. It seemed prudent to limit the application of the performance criteria to the periods between the scheduled reviews, and to reformulate the criteria as a matter of course on the occasion of each review.

The staff's medium-term outlook for the economy, based on the assumption that appropriate policies were maintained, Mr. de Groote remarked, suggested that a viable balance of payments position could be restored only after an adjustment period of five or six years. As sobering as that forecast was, it was in fact based on relatively optimistic assumptions about the continuation of the ongoing recovery in the OECD countries. A new recession, or stagnation, in the industrial world would further postpone the attainment of a sustainable external situation in Zaïre, as the country's export earnings probably could not increase by 10 percent a year through 1989, as the staff had assumed in its scenario.

It was therefore essential, Mr. de Groote went on, that all economic policy decisions adopted in Zaïre in the coming years, and the attitude of Zaïre's creditors should be based on the assumption that a long and sustained internal effort would be required and external assistance would be needed to reach a viable economic position. A better than forecast economic performance in the industrial world should not encourage Zaïre to adjust its efforts. Instead, the authorities should understand that the only possible way of shortening the adjustment period was to maintain corrective policies even if external conditions improved.

At the same time, Mr. de Groote said, Zaïre's creditors could not fail to draw the conclusion from the staff's analysis that it would be necessary to reschedule Zaïre's external debt obligations and provide exceptional financial assistance until 1988. The Belgian Government had decided to contribute to the efforts of the group of countries that wished to assist Zaïre in the framework of a Fund-supported program. Technical assistance would be reinforced in critical sectors, and the National Bank of Belgium had decided to increase its credit line to the Bank of Zaïre by 50 percent. The special relationship between Belgium and Zaïre was reflected in the geographic distribution of Belgium's foreign assistance, which remained an important aspect of the Belgian Government's policy.

Commenting on Zaïre's debt, Mr. de Groote said that a more appropriate debt rescheduling technique was needed for Zaïre and other debtor developing countries. One approach would be to establish a link between the schedule of reimbursements and the current debt service capacity of the debtor country. Accordingly, repayment would be accelerated when export prices and volumes increased, and it would be slowed when they decreased. Such arrangements should be fully negotiated on a case-by-case basis between the debtor country and its public and private creditors, and they should be accompanied by the implementation of Fund-supported stabilization programs. Such an approach would help a country to gear its debt profile to its economic performance.

He felt confident about the authorities' proposed program, Mr. de Groote stated, and he strongly supported the proposed decisions. Given the unusually long period of the application of the shadow program, and the acceptance of the need for fundamental structural measures, the amount of financing under the proposed program seemed to be on the low side. He hoped that it would be possible to revise the stand-by arrangement upward, in order to provide a higher percentage of Zaïre's new quota in 1984.

Responding to a question, Mr. de Groote said that it was true that real incomes in Zaïre were difficult to measure because of the poor quality of the relevant indices, but there had apparently been a sizable reduction in real incomes, mainly because of the decline in the terms of trade. Under the proposed program, it would be best to aim for a tolerable decline in real incomes together with a progressive resumption of economic activity, so that the country could meet its payments obligations while improving the overall domestic position and the balance of payments over five or six years. Incomes in Zaïre were already fairly low, and excessive downward pressure resulting from a slowing of manufacturing activity and agricultural investment might not only depress them further, but also undermine the country's ability to meet its payments obligations and restore a viable balance of payments position.

Mr. Lovato stated that he broadly agreed with the staff appraisal and accepted the proposed decisions. The amount of the proposed stand-by arrangement was the equivalent of 100 percent of quota. The staff report had been circulated several days before the Executive Board's discussion of the criteria for the amount of access in individual cases, and the staff could not have foreseen the outcome of that discussion. Although the new access criteria would be applied in 1984, they reflected a practice that had been evolving over the recent past under which the Executive Directors encouraged the staff to explain in detail the reasons for the proposed specific amounts for arrangements, including the staff's views on the size of the payments imbalance and financing need, the strength of the adjustment program, and the member's record of cooperation with the Fund. A further comment by the staff on the amount proposed for Zaïre would be helpful.

A cause for concern in the present case, Mr. Lovato continued, was Zaïre's poor record of cooperation with the Fund under previous programs and its failure to implement required corrective policies. The experience with the extended arrangement, which had been canceled in 1982, was disappointing. After a strong start, the adverse global economic environment and the slippages and deficiencies in policy implementation and administrative control had caused fiscal developments to deviate from the program path, thereby undermining the efforts to control price increases and to improve the external payments position.

Commenting on the proposed adjustment program, Mr. Lovato said that two important qualities of its design were the strong emphasis on prior policy actions and the carefully delineated medium-term framework. Prior actions in one period paved the way for rapid adjustment in a later period for two reasons. First, in most cases, there were long delays before the effects of policies worked their way through the real economy. Second, the announcement of early and determined policy actions had the positive effect of rebuilding the confidence of potential creditors and restoring flows of external finance to the country concerned. In the case of Zaïre, the authorities had in effect been obliged to introduce an array of prior stabilization measures. Without a clear signal from the authorities that they were resolved to correct the most serious imbalances in the fiscal, monetary, pricing, and exchange rate areas, the adjustment program could not have been started on a sound footing.

In the fiscal policy area, Mr. Lovato continued, the authorities were emphasizing expenditure control. Two measures were particularly encouraging, namely, the centralization of government spending authority at the Ministry of Finance and Budget, and the inclusion among the policy understandings of quarterly targets on budget expenditure, together with a provision for payments for external debt and arrears. On the revenue side, the staff had estimated that in 1983 the revenue gains from the devaluation and the new fiscal regime for GECAMINES would amount to more than Z 4 billion, compared with the increase in total revenues of about Z 5 billion. What would be the revenue yield of the same measures in 1984 as a share of the projected Z 9 billion in additional tax receipts for the year?

The restrictiveness of monetary policy was reflected in the target, namely, to bring about a deceleration in the rate of monetary expansion, which had soared in 1982, Mr. Lovato noted. However, despite the liberalization and upward revision of interest rates, they were still low and did not appear to be consistent with the desired degree of monetary restraint; a large element of interest subsidization had persisted. That the credit ceilings had been set as performance criteria only for end-December 1983 was surprising. There was no apparent reason for permitting great latitude in the credit area in 1984.

The authorities had made significant progress in liberalizing the price structure in recent years, Mr. Lovato remarked, and he hoped that the prices that continued to be controlled would be managed in a flexible fashion, as the staff had indicated. In particular, the authorities should be urged to ensure that tariffs and public utility charges promptly reflected the new constellation of prices.

He agreed with the staff that the recent reforms of the exchange and trade system were far-reaching, Mr. Lovato said. The floating exchange rate regime, together with the large devaluation of the currency and the liberalization of the foreign exchange allocation and import licensing systems, should give considerable stimulus to Zaïre's external adjustment.

Commenting on the balance of payments outlook and the financial support required by Zaïre, Mr. Lovato remarked that the proposed ceilings for new external government borrowing of SDR 100 million and SDR 150 million in 1983 and 1984, respectively, seemed to be too high to be regarded as what the staff had called "a strict minimum." In addition, why did the staff expect the volume of short-term borrowing to be so small, and why was it not covered by the performance criteria? Presumably the answer was that Zaïre's creditors were not prepared to grant short-term credit to the country. The staff's detailed assessment of the outlook for the balance of payments and external debt position in the period well beyond the end of the proposed program was welcome, although a presentation of scenarios in addition to the one preferred by the staff would have been helpful. In addition, the staff could have included in the report its analysis of the effects of various different sets of assumptions. As for the request to use the compensatory financing facility, the staff had made a convincing case.

The Fund membership was to some extent jointly responsible for the success of Zaïre's program, as well as for the success of other programs of member countries, Mr. Lovato considered. Countries should cooperate by giving generous financial support and by maintaining appropriate international economic policies. Of course, most of the responsibility for the success of the program rested with the Zaïrian authorities themselves, and they were to be commended for the good start that they had made and should be urged to implement with determination the policies outlined in their letter of intent.

Mr. Clark said that both draft decisions were acceptable. Considerable time had passed since the previous Article IV consultation with Zaïre, and the staff's intention of holding the next consultation on the regular 12-month cycle was welcome.

Economic conditions in Zaïre had seriously deteriorated since the mid-1970s, Mr. Clark continued, partly because of the fall in commodity prices, and partly because of inadequate policies. Efforts had been made to check the decline, but they had not been either sufficiently vigorous or sustained, until the latest attempt, which had begun about a year ago with a tightening of fiscal policy. Significant results had been achieved in the fiscal area in the first half of 1983. Soon thereafter measures reforming the principal parastatal enterprises, stimulating agricultural development, and freeing domestic prices had been implemented, and in September 1983 there had been a dramatic improvement in the foreign exchange system that had apparently had favorable results thus far. Hence, the main policy elements of the adjustment effort were in place and seemed to be working.

Commenting on the proposed program, Mr. Clark said that the slight front-loading of drawings seemed justified and was a good example of the synchronization of drawings with the implementation of policies. In addition, the two scheduled reviews should facilitate close monitoring of the implementation of the program.

The delay in the first disbursement under the proposed program until the financing gaps for 1983 and 1984 had been covered was appropriate, Mr. Clark considered. Even if the proposed program was implemented, Zaïre would not achieve external viability and the debt service ratio would remain well over 30 percent, even on the basis of the fairly optimistic assumptions about the price of copper. Similarly, even if the debt reschedulings were exceptionally favorable, donor countries provided support, and the adjustment program was fully implemented, Zaïre would have to undertake further adjustment, possibly under additional Fund-supported programs, to achieve a sustainable balance of payments position by the end of the 1980s. For that reason, the size of the proposed program was appropriate.

The firm action that had already been taken to reduce the budget deficit was commendable, Mr. Clark said. He agreed with the staff that particularly rigorous action would be required with respect to the items for which overruns had been persistently recorded in the past. In that connection, he was concerned that the budgetary control during the previous year had been achieved in part by delaying payments to contractors. The centralization of all expenditure authorizations within the Finance Ministry was welcome, and he wondered whether the staff was now satisfied with the administrative control procedures.

As for monetary policy, Mr. Clark remarked, the recent substantial adjustment and liberalization of commercial interest rates was a welcome step toward the establishment of positive real interest rates. Higher domestic savings would relieve pressure on the private sector, which in the previous several years apparently had been squeezed by the pre-emption of resources by the public sector. The absence of any discussion in the staff report on the levels of real interest rates was surprising; presumably some of the interest rates were substantially negative. Did the staff intend to deal with the matter in greater detail during one of the scheduled reviews, when, perhaps, the rate of inflation would be less volatile? The authorities certainly should be urged to raise interest rates to positive real levels.

Commenting on the exchange system, Mr. Clark said that the reform permitting commercial banks to set exchange rates in response to movements in supply and demand, together with the abolition of certain exchange surrender requirements, was welcome. The abolition of residents' foreign currency accounts might help to reduce the importance of the parallel market. It would be useful to receive a staff comment on the working of the new foreign exchange allocation system. The working of the exchange system should certainly be a major topic during the next review. If Zaïre's market rate fixing mechanism was successful, it might have wider applications in other countries. Zaïre's elimination of the remaining multiple currency practice was welcome, but the authorities should be urged to terminate the remaining bilateral payments arrangements with Burundi and Rwanda.

Zaïre's debt position remained serious, Mr. Clark noted. The debt service ratio was likely to remain at about 40 percent for the next three years and was projected at more than 20 percent by the end of the 1980s on the basis of what seemed to be rather optimistic export projections. The authorities must exercise extreme caution in taking on any further debt, particularly short-term debt. He strongly favored making the reduction of external arrears a performance criterion. The progress in that area should be checked during the scheduled reviews, as it would play a vital role in restoring Zaïre's creditworthiness.

He supported the proposed stand-by arrangement mainly because the major underlying policy actions had already been taken, Mr. Clark stated. He looked forward to a careful monitoring of the program in the coming period.

Commenting on the proposed use of the compensatory financing facility, Mr. Clark said that exogenous factors had been mainly--although not exclusively--responsible for the export shortfall. Copper accounted for about 15 percent of the total shortfall, and although the copper price forecast for Zaïre was significantly less optimistic than the 20 percent rise a year forecast in the recent case of Zambia, the projections for Zaïre were viewed by his chair with some skepticism. In projecting the postshortfall recovery, how much account had been taken by the staff of the structurally weak demand? In any event, there seemed to be a difference between the projections of copper prices in EBS/83/260 and EBS/83/257, the one predicting an average price in the year to March 1984 of $0.71 per pound, the other $0.73 per pound. The proposed purchase was acceptable, but given the uncertainties about measuring the size of the shortfall, the purchase would have been easier to support if it had been less than the measured export shortfall.

Mr. Grosche noted that external factors had played an important role in creating the problems facing the economy. The fall in copper and cobalt prices would have posed a threat to the economic well being of any country with a pattern of exports like that of Zaïre. However, the staff had clearly shown that domestic economic mismanagement was the main cause of the present difficult economic situation in the country. The foreign exchange earned when the prices of exports had been high and overall sales had flourished had not been used productively. Accordingly, no progress had been made in improving the infrastructure and in diversifying the economy, for instance, in the agricultural sector. That outcome was especially unfortunate in view of Zaïre's substantial resource base.

He had some reservations about the proposed program, Mr. Grosche continued. He recognized that the authorities had already introduced a series of measures that should certainly be seen as steps in the right direction, and that the proposed program was aimed primarily at tackling the balance of payments problem. At the same time, however, the staff had concluded that, on the basis of certain assumptions, a viable balance of payments position could be reached only in five or six years. Hence, he wondered whether the authorities' overall approach was not excessively gradual and cautious. Apparently prices could be further decontrolled, and the complete elimination of controls would be preferable to administering them "flexibly" as the staff had suggested. Given an inflation rate of 68 percent in 1983 and an estimated 47 percent in 1984, the increase in the central bank rediscount rate, from 15 to 20 percent, seemed rather moderate. The planned rapid elimination of the budget deficit was impressive, but he wondered whether it would be sustainable. In addition, the share of capital expenditures for agriculture in overall expenditure seemed rather small.

His doubts, Mr. Grosche continued, had been fueled in part by the unsuccessful implementation of previous Fund-supported programs for Zaïre. Still, given the assurances provided by Mr. Alfidja and the staff, the fact that the proposed drawings were contingent upon a successful outcome of the rescheduling negotiations, the prior actions that had been taken, and the planned close monitoring of the program, he could go along with the proposed stand-by arrangement.

The size of the proposed arrangement, Mr. Grosche considered, was in the upper range of permissible access, especially when account was taken of the length of the adjustment period, the likely need for additional Fund-supported programs, and Zaïre's debt to the Fund. Finally, the proposed purchase under the compensatory financing facility was acceptable, although he shared some of Mr. Erb's doubts arising from the role of exchange rate policy in the development of the export shortfall.

Mr. Ajayi observed that the economy had faced difficult problems in recent years, including a low level of economic activity, a high rate of inflation, and serious external imbalances. The unfavorable economic situation had been caused in part by problems that had been beyond the control of the authorities, such as the sharp deterioration in the terms of trade, but domestic policies had also played a role. In the recent past, however, the authorities had attempted to implement corrective measures under a number of adjustment programs. Although many of the measures--such as the 55 percent devaluation in 1979/80, the increases in producer prices and interest rates, and the number of institutional reforms aimed at improving economic management--could be regarded as bold, they had not been sufficient to bring the economy back on track. The authorities' further efforts under the proposed program were therefore welcome, as they were designed to restore a viable domestic economic situation and a sustainable balance of payments position.

The measures that the authorities intended to introduce through end-December 1984 were appropriate and seemed to be in the right direction, Mr. Ajayi considered. Particular importance should be attached to the exchange rate adjustment. The large devaluation and the implementation of a floating exchange rate regime had been a difficult task for the authorities, particularly because of the adverse effect on the high rate of inflation. How long would it take for the inflationary effect of the devaluation to subside? Prolonged inflation would certainly hurt the economy.

The Government's investment program covered the key areas of agriculture, transportation, infrastructure, and energy, Mr. Ajayi noted. The proposed changes in pricing policy and recent developments in the fiscal and monetary areas were welcome. The removal of certain import taxes on basic consumption goods should help to ameliorate the adverse impact of the devaluation.

The medium-term outlook remained somber, Mr. Ajayi remarked, but he hoped that the program could be kept on track, and that Zaïre would be able to maintain an adequate inflow of financial resources. The outcome of the rescheduling of the country's external debt would be important.

Commenting on the proposed purchase under the compensatory financing facility, Mr. Ajayi said that the decrease in copper prices was clearly the cause of the serious shortfall in Zaïre's export earnings. The staff had made a strong case in favor of the proposed purchase. He agreed that the factors behind the shortfall were largely beyond the control of the authorities, and that Zaïre had met the test of cooperation. The staff's projected increase in export earnings in the two postshortfall years seemed appropriate.

Mr. Polak commented that the staff had painted a clear picture of the background to the present problems facing the economy and had stressed the vital importance to Zaïre of implementing a relatively austere program. The staff appraisal was well balanced and he broadly agreed with it.

A number of severe measures had been implemented during the previous 12 months, and particularly on September 12, 1983, Mr. Polak noted. Together they had given the needed signal that the authorities were resolved to implement a strong adjustment program. The first review of the program was scheduled to take place in the near future, and taken together the scheduled reviews would be important. The staff had clearly shown that external assistance in addition to the Fund's resources would be indispensable and would have to include an exceptional debt rescheduling. Still, even with the Fund's support in the proposed debt rescheduling, the balance of payments financing gap in the coming two years would remain large. The outlook for capital inflows in the near future was unfavorable because of Zaïre's history of accumulating arrears. He hoped that the country's basic investment potential would encourage an inflow of foreign capital once the adjustment program proved to be successful. At the same time, the need for the Fund's financial support would decline, although a need for some Fund financing would probably remain.

He looked forward to the staff's response to questions about the determination of the size of the proposed stand-by arrangement, Mr. Polak commented. The success of the program would depend to a significant extent on developments in the world copper market. If world prices did not increase as much as had been assumed, the success of the program could be placed in jeopardy at a time when Zaïre would have used up most of its total access to the compensatory financing facility. Mr. de Groote's suggestion for possibly structuring a country's debt service partly as a function of the development of its exports was interesting, and the staff should be encouraged to study it.

In the present case, as in some previous ones, he was concerned about the relevance of the performance criteria under the proposed program, Mr. Polak commented. Zaïre's program was indeed a comprehensive one; it contained a number of measures in practically all the areas of interest to the Fund, including the exchange rate, pricing, revenues, and monitoring policies. However, the staff correctly attached considerable importance to Zaïre's history of financial mismanagement--a major cause of the failure of previous Fund-supported programs--and the financial aspects of the new program could have been usefully focused more directly on the financial performance of the Government. On page 27 the staff had mentioned a large number of important financial reforms dealing with budgetary control that were the basis for quarterly targets for key expenditure categories, including outlays of the presidency and political institutions, and total budgetary expenditures. It was unfortunate, although perhaps unavoidable, that the performance criteria had not been directly tied to the sectoral targets for the government sector. Some of the expenditures could become excessive, thereby making it impossible for the authorities to meet the overall targets, or enabling them to be met only on unsatisfactory terms. In the present case, as in the recent one of Brazil, close and effective monitoring of the progress under the program would be important. In that connection, Mr. de Maulde's suggestion for appointing a resident representative seemed useful.

He also wondered about the relevance of the performance criteria on the external debt, Mr. Polak went on. As Mr. Lovato had noted, the short-term debt might admittedly not be important at the present stage because such debt might not be available, but there was no certainty of that. The lack of control over short-term debt through the proposed program performance criteria was a notable omission. In general, however, the proposed decision on the consultation and stand-by arrangement was appropriate, and it should be approved.

He was fully satisfied with the substance of the proposed decision on the purchase under the compensatory financing facility, Mr. Polak stated. However, he wished to raise a question of principle with respect to the test of cooperation. At the bottom of page 17 the staff had stated that "the authorities have adopted a comprehensive adjustment program in support of which they are requesting a 15-month stand-by arrangement." That justification was the correct one for a country that met the cooperation requirement on the basis of recently adopted policies. The staff had not said that Zaïre met the requirement of cooperation, only that it would meet the requirement after the stand-by arrangement had become effective. In other words, the actual implementation of the stand-by arrangement and approval of the proposed purchase would be conditional upon the successful financing arrangement in the Paris Club and elsewhere; the proposed decision contained a clause to that effect. That approach was not in accordance with either established policy on conditionality or the cooperation requirement for compensatory financing, and the clause that he had mentioned, which was contained in paragraph 2 of the proposed decision, could be deleted. It was reasonable to see the adoption of the proposed stand-by arrangement as an adequate test of cooperation, but basing the actual date of implementation on something on which the Executive Board would not make a direct judgment seemed inappropriate. After all, a stand-by arrangement was not a requirement for meeting the test of cooperation, although, in the present case, the acceptance by the Executive Board of the stand-by arrangement was a reasonable way of having the country meet the test of cooperation.

Mr. Nimatallah remarked that, as a technical matter, it was appropriate to assume that the test of cooperation had not been met until the stand-by arrangement was approved. As Mr. Polak had noted, the adoption of a stand-by arrangement normally was not a requirement for meeting the test of cooperation. However, given Zaïre's poor track record, the staff had felt that the approval of the proposed stand-by arrangement was the only way that the country could meet the test of cooperation. The proposed approach should not be used in all cases; but it seemed to be an appropriate way of dealing with the present case.

Mr. Zhang said that he was worried that the proposed approach for Zaïre might set a precedent that would be cited in future cases. Nevertheless, the proposed decisions were acceptable.

The Executive Directors should not be too harsh in judging the present economic situation in Zaïre, Mr. Zhang considered. When seen in its historical perspective, the task of transforming the colonial economy into an independent national economy had clearly been hazardous and difficult. In comparison with most developing countries, Zaïre's starting point had been much less favorable in terms of infrastructure, level of education of the population, and public administration. Moreover, the economy had been dominated by strong multinational corporations. It was true that inadequate internal policy measures had been responsible to some extent for the problems facing the country in recent years, but the adverse effect of external factors should not be underestimated. In that respect, Zaïre's experience was no different from that of other developing countries and should be viewed accordingly.

The staff reports contained no explicit discussion of the role of multinational corporations in the development of Zaïre's economy, Mr. Zhang noted. Had such corporations had an important effect? Had their influence been beneficial to Zaïre's economic transformation?

The staff favored a large devaluation of the zaïre, Mr. Zhang observed. Since the prices of Zaïre's exports were quoted in U.S. dollars in world markets, could a devaluation stimulate world demand for the country's exports? How would the terms of trade, expressed in zaïres and U.S. dollars, respond to such a large devaluation?

The staff had recommended the introduction of an export tax after the devaluation, Mr. Zhang remarked. The receipts of the tax were to be used to finance the budget deficit. Precisely how would such a mechanism work? Would the tax receipts more than offset the increase in export receipts in zaïres resulting from the devaluation? Would the tax lead to a reduction in the remittances of profits abroad by foreign corporations?

The staff representative from the African Department commented that management and staff had themselves raised the questions that Executive Directors had posed about the best way to approach Zaïre's record of performance under previous Fund-supported programs and the recently introduced economic and financial policies. One of the questions that had been considered was whether Zaïre's poor track record should preclude its use of Fund resources under a new adjustment program. At the same time, management and staff were keenly aware of the importance of treating members equally. In the circumstances, it had been concluded that, before bringing a request by Zaïre for further use of Fund resources to the Executive Board, there should be reasonable assurances that the country's performance under the new program would be satisfactory.

The staff had had no difficulty in concluding that the authorities had initiated a number of strong prior actions in 1983, including a fundamental exchange rate reform that in many respects was more far-reaching than any such reform undertaken since the late 1960s, the staff representative went on. The Government's reform effort in the exchange rate area would have to be watched closely, in part because it might be of interest to other countries in a similar situation. Zaïre had substantially liberalized the exchange and trade system as well as lending rates, and it had continued the process of domestic price liberalization initiated in 1981. Moreover, the authorities had maintained a prudent wage policy, despite the difficult social situation, and they had tightened fiscal and credit policies and had tried to improve the operations of GECAMINES and SOZACOM, the core of the vital mining sector. As a result, the authorities had shown over a period of more than nine months a satisfactory performance, thereby giving management and staff good cause for bringing the country's latest request to the Executive Board. That process had taken time, however, and it was in that context that the gap between Article IV consultations had become relatively large. It would have been difficult to interrupt the process of negotiations in mid-1983 in order to conclude the consultation procedure. The negotiation process had been a continuing one, and the staff felt that it would be best to bring to the Executive Board a fully thought-out set of policies and objectives, rather than an incomplete set. Moreover, the proposed stand-by arrangement included a provision for two reviews and, assuming that it would enter into effect as soon as the necessary rescheduling had been concluded satisfactorily, the first review would probably take place in early 1984, and the second one in about mid-1984.

Commenting on wage policy, the staff representative noted that the last wage increase in the government sector had been granted in August 1982. In that year, the increases had been limited to 20 percent, well below the inflation rate of 37 percent. Given the already high rate of inflation and the likely effects on prices of the exchange rate adjustment, the whole question of wages had had to be addressed. The authorities had decided to limit the rise in the government wage bill to 40 percent over the two-year period 1983-84, compared with an estimated inflation rate of 68 percent in 1983 and 47 percent in 1984. It was of course possible that the rate of inflation in 1984 would be less than 47 percent; nevertheless, the relationship between wage increases and inflation in Zaïre seemed to compare favorably with the relationship under adjustment programs for other countries. In the nongovernment sector, agreements had already been signed with the unions and the organization representing business enterprises for increases of 45 percent in 1983-84. In general, the wage situation was thought to be very tight. On the other hand, it was important to see wage policy in the government sector in the light of the budgetary constraints, and to see public and private wage developments in the context of the overall growth of demand that could be tolerated under an adjustment program.

Steps had already been taken to return a large number of nonfinancial public enterprises to the private sector, the staff representative explained. In addition, in November 1983 the tariffs of the main public utility companies had been raised substantially, and they would continue to be adjusted in the light of price and cost developments. The most important public enterprise in Zaïre, GECAMINES, was fully owned by the Government. Another major public enterprise, SOZACOM, was also owned by the state.

The staff had clearly stated that there were substantial external arrears, the staff representative remarked, and that the expectation was that some of the arrears would be liquidated shortly. The bulk of the arrears would probably have to be rescheduled in the context of the overall rescheduling arrangements. As for the so-called commercial and invisible arrears, the program aimed to settle approximately one fourth of them in 1983-84. The staff had not spelled out the likely scenario of events in the medium run, but it assumed that the remaining commercial and invisible arrears would be liquidated in the coming four or five years. In that connection, there was an important question of comparability between debt service payments and liquidation of the purely commercial arrears. All the commercial arrears could perhaps be easily liquidated, but such an action would have implications for the country's debt service, which was expected to increase from about $220 million in 1983 to more than $310 million in 1984, if all the assumptions behind the estimates proved to be accurate.

The Fund staff had collaborated closely with the World Bank staff, the staff representative explained, and both were in basic agreement on the policies that were needed to improve Zaïre's economic situation. The World Bank staff had been particularly pleased by the exchange rate reform, initiated under the program, and especially the permanent flexibility that it would provide. The Fund staff planned to participate in the meeting of the Consultative Group for Zaïre--which was chaired by the World Bank--in the coming week. Of course, the World Bank had taken a leadership role in certain key sectors, for instance, the management and operations of GECAMINES.

Commenting on the suggestion for appointing a resident representative in Zaïre, the staff representative explained that the Fund was already making a sizable technical assistance effort. The Fund was assisting the Bank of Zaïre through a principal manager and through advisors in the fields of research, foreign exchange management, and arrears. In addition, an advisor would be provided in early 1984 in the area of the new interbank foreign exchange market. The stationing of a staff member as resident representative in Kinshasa was also under active consideration.

The question had been raised, the staff representative recalled, whether the ex post price controls had been a constraint on private sector activity. The controls were still in place, but they were seldom vigorously enforced by the authorities. At the same time, the authorities felt that the mere possibility of intervention might well discourage excesses by the private sector. In this regard, the authorities had informed the staff that some private enterprises had taken advantage of the recent exchange rate adjustment to boost their prices even more than was actually necessary. Hence, the authorities saw a need at least to keep these controls in place. The staff planned to take another look at the matter in the context of the scheduled review of the program.

Under the proposed program, the staff representative remarked, the commercial banks were to decide what the lending interest rates should be. Since most lending rates had been freed, they had moved in the range of 22-35 percent. Deposit interest rates had not been freed because the authorities were concerned that the commercial banks might actually decrease those rates.

He agreed with Mr. Erb that a larger increase in reserves than the authorities had planned would be desirable, the staff representative from the African Department said. However, given the known financial constraints and the expected support from sources in addition to the Fund, the staff had concluded that the authorities could do little more in the area of reserves than they had actually planned. Still, an increase in reserves was a desirable medium-term objective, as it would provide a cushion against unforeseen adverse developments. In that connection, it it was of course difficult to predict with any great confidence the evolution of the international price of copper, but the estimated $45 million increase in reserves in 1984 could serve as a useful safety margin. In looking at the medium term, the staff could certainly provide alternative balance of payments scenarios based on various likely developments for such important variables as exports and capital disbursements. The staff's present medium-term scenario was similar to what the World Bank staff called a constrained recovery scenario, which was not the most satisfactory in the eyes of the World Bank. The Fund staff, however, had had in mind the crucial financial constraints in the coming years.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/173 (12/14/83) and EBM/83/174 (12/16/83)

3. EAST AFRICAN DEVELOPMENT BANK - HOLDER OF SDRs

1. Prescription as a Holder

The East African Development Bank is prescribed, in accordance with Article XVII, Section 3(i) of the Articles of Agreement, as a holder of SDRs.

2. Terms and Conditions for Acceptance, Holding, and Use of SDRs

The East African Development Bank is authorized to accept, hold, and use SDRs in transactions and operations in accordance with and on the terms and conditions specified in Executive Board Decision No. 6467-(80/71) S, adopted April 14, 1980. ("Terms and Conditions for the acceptance, holding, and use of Special Drawing Rights by other holders, prescribed under Article XVII, Section 3."). (EBS/83/265, 12/8/83)

Decision No. 7582-(83/174) S, adopted
December 15, 1983

4. ASSISTANTS TO EXECUTIVE DIRECTORS

The Executive Board approves the appointments set forth in EBAP/83/304 (12/12/83) and EBAP/83/305 (12/12/83).

Adopted December 14, 1983

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/309 (12/14/83) is approved.

APPROVED: April 12, 1984

LEO VAN HOUTVEN
Secretary