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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/28

10:00 a.m., March 12, 1982

E/82

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

Executive Directors

J. de Groote
B. de Maulde

T. Hirao
J. C. Iarezza
R. K. Joyce
A. Kafka
B. Kharmawan
S. Kiingi

G. Lovato
S. Nana-Sinkam

J. J. Polak
A. R. G. Prowse

Zhang Z.

Alternate Executive Directors

O. Kabbaj
C. Taylor
M. A. Senior
H. G. Schneider
A. Le Lorier
T. A. Connors, Temporary
T. Alhaimus
T. Yamashita

G. Jauregui, Temporary
V. Supinit
F. Sangare
P. Kohnert, Temporary
C. P. Caranicas
A. Alfidja
A. S. Jayawardena
S. El-Khoury
T. de Vries
B. Legarda
L. Vidvei
Tai Q.

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

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Also Present

Administration Department: W. Bier. African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; E. L. Bornemann, E. A. Calamitsis, F. d'A. Collings, S. E. Cronquist, J. Harnack, A. Jbili, O. E. G. Johnson, M. Reichardt, M. Sidibe, D. E. Syvrud, W. B. Tshishimbi. Asian Department: K. A. Al-Eyd, R. Baban, P. Chabrier, H. C. Kim. Central Banking Department: P. N. Kaul, Director; P. Duvaux. European Department: H. Ungerer. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; E. H. Brau, H. W. Gerhard, S. Kanesa-Thasan. External Relations Department: A. M. Abushadi. Fiscal Affairs Department: G. A. Mackenzie. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, S. A. Silard. Middle Eastern Department: H. E. Jakubiak. Research Department: K.-Y. Chu, L. U. Ecevit, N. M. Kaibni, G. Khatchadourian, E. A. Milne, T. K. Morrison, A. Muttardy, P. Radhakrishnan, B. R. H. S. Rajcoomar. Treasurer's Department: R. J. Familton, Deputy Treasurer; A. M. Al-Samarrie, W. L. Coats, D. S. Cutler, D. Gupta, A. F. Moustapha, M. Sami, T. M. Tran, G. Wittich, B. B. Zavoico. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, C. Bouchard, S. E. Conrado, A. B. Diao, M. A. Janjua, F. A. Turreilles, F. Yeo T. Y. Assistants to Executive Directors: E. M. Ainley, L. Barbone, M. J. Callaghan, L. E. J. Coene, R. J. J. Costa, M. K. Diallo, F. G. Guena, A. Halevi, J. M. Jones, J. S. Mair, L. Merckx, M. Michelangeli, W. Moerke, V. K. S. Nair, Y. Okubo, J. Pedersen, C. N. Pinfield, M. Z. M. Qureshi, J. Reddy, D. I. S. Shaw, H. Suzuki, O. Üçer, P. Verly, J. F. Williams.

1. REPORT BY MANAGING DIRECTOR

The Chairman reported on his recent trip to Canada.

The Chairman said that he had made a number of interesting contacts with Canadian authorities during his two-day trip. On the first day he had expressed the Fund's views on important policy matters in Canada and on the world economic situation at a meeting with Cabinet Ministers responsible for economic policy. In particular, he had underscored the importance of continuing to give priority to the counterinflation policies that the Government had stressed in its November 1981 budget report. He had also attended a dinner in Ottawa hosted by the Minister of Finance where, during a long and remarkably frank conversation among Ministers, high-ranking officials, bankers, and other businessmen, he had gained invaluable insights into the workings of the Canadian economy.

At a luncheon hosted by the central bank on the first day of his visit, the Chairman continued, there had been a most interesting and useful review of Canadian and international monetary problems followed by a lengthy discussion with the Minister of Finance and other concerned officials of the coming meeting of the Interim Committee. They had reviewed in detail the discussions at recent meetings and the matters that they hoped the Interim Committee would address in Helsinki, including the World Economic Outlook, the Fund's general policies, quotas, and SDRs. There had been broad agreement that the discussion on the World Economic Outlook at the Interim Committee meeting in Helsinki would provide a useful backdrop to various subsequent international meetings, including the Versailles summit in June, the 1982 Annual Meetings in September, and the ministerial meeting of the GATT in the fall of 1982. Accordingly, the Executive Board should spend more time than usual on its forthcoming consideration of the World Economic Outlook. It could devote one day to examining the interaction between the various policy options available to the major industrial countries, particularly with respect to interest rates, exchange rates, monetary policy, and efforts to eliminate stagflation. A second day could be devoted to examining other, broader problems, such as the difficulties facing oil exporters and non-oil developing countries in the light of the recent sharp changes in conditions in the oil markets, and the implications of the changes for international capital flows and other items dealt with in the World Economic Outlook papers. That approach should help to focus the discussion in Helsinki on the World Economic Outlook. The large number of statements that government officials had made in recent months on such problems as high interest rates and large fiscal deficits should encourage the Fund to take an objective look at them; the issues had sometimes been misinterpreted in press reports.

The second day of his trip had been spent in Toronto, where he had addressed the Investment Dealers Association, the Chairman explained. Economic policy questions had been widely discussed during his stay in Canada, and his speech had been well covered by the Canadian press.

Broadly speaking, his trip constituted a part of the Fund's surveillance effort, and he was pleased with the number of useful contacts that he had been able to make in such a short time.

The Executive Directors took note of the Chairman's statement.

2. SPECIAL DRAWING RIGHTS DEPARTMENT - DESIGNATION PLAN FOR MARCH-MAY 1982; AND OPERATIONAL BUDGET FOR MARCH-MAY 1982

The Executive Directors considered staff memoranda setting out the designation plan for March-May 1982 (EBS/82/33, 2/26/82) and the operational budget for March-May 1982 (EBS/82/32, 2/26/82).

Mr. Kharmawan said that his Indonesian authorities had no objection to the inclusion of Indonesia in the proposed designation plan and operational budget. His Singapore authorities, however, felt uneasy about the proposed inclusion of Singapore dollars in both the designation plan and the operational budget. They recognized that the proposed inclusion of Singapore had resulted from the application of certain established guidelines but, as he had said on a number of previous occasions, they felt that the guidelines were inappropriate. He looked forward to discussing the new staff paper on the guidelines and would use that occasion to make a more detailed presentation of his views on them. He hoped that the matter of remuneration on reserve positions in the Fund could be dealt with at the same time, and that the Fund could agree on guidelines that were acceptable to all members. As a general rule, the Fund's basic policies should not be inconsistent with the role that quotas played in determining member countries' access to Fund resources, SDR allocations, and voting power.

Mr. Kabbaj remarked that his authorities in Algeria and Oman had not yet informed him of their position on the proposed designation plan and operational budget. He did not foresee any difficulties, but he did wish to reserve his position.

Mr. Vidvei stated that the proposed decision on the operational budget was fully acceptable. Section 10, on actual developments in the Fund's liquidity, was a welcome addition to the staff's usual presentation of the operational budget. He was pleased that the technical financing gap on a commitment basis of about SDR 600 million was much smaller than the forecast gap of SDR 2.7 billion, but the fact that the small size had been due almost entirely to the unexpectedly limited volume of commitments of borrowed resources, because of delays in some of the new borrowing arrangements, was worrying. No new borrowing agreements had been concluded since December 1981, and he wondered what were the prospects for concluding new ones in the near future.

Future papers on the operational budget, Mr. Vidvei continued, should show, in Table 5, the Fund's financing gap and other data on the institution's liquidity position. The text of Section 10 on pages 7 and 8 was

difficult to analyze because it was not clearly related to the tables in the annex, especially Table 5. The presentation of the data in Table 5 should be such that the relationships between the various elements of the Fund's liquidity could be easily examined. To that end, it would be useful to include the likely financing gap in the months covered by the operational budget.

Mr. Connors stated that he had no objection to the proposed operational budget, which included a significant volume of U.S. dollars. It would be useful to receive a comment on the agreement to use the equivalent of SDR 50 million in pounds sterling. At first glance, the amount seemed rather moderate, given the size of the Fund's holdings of pounds sterling.

Mr. Polak said that he wondered whether the comparison between asset and liquidity ratios, which the staff had promised to make, would be included in the new paper on the guidelines for including currencies in the designation plan and operational budget.

The staff representative from the Treasurer's Department responded that the issue that Mr. Polak had mentioned would be dealt with in the new staff paper reviewing the policy on sales of SDRs and currencies in the General Resources Account.

The staff's commitment, the staff representative continued, had been that its quarterly paper on the operational budget would deal with the actual position of the Fund and would not examine likely prospective commitments. Still, the staff's approach to what would be presented in the quarterly currency budget and in the six-monthly liquidity reviews was in a transitional phase, and the staff would certainly wish to take Mr. Vidvei's comments into account in preparing future papers.

The staff greatly appreciated the cooperation that the U.K. and Chilean authorities had shown in agreeing to include their currencies in the operational budget for March-May 1982, the staff representative said. Hitherto, under a decision adopted by the Executive Board in 1981, there had been a set method of relating the amount of pounds sterling to be sold to the amount that the United Kingdom would likely have had to repurchase under the decision on early repurchases. However, that decision stated that, once the amount of outstanding repurchases was less than the amount of currency that had been sold, there could be an ad hoc agreement on an amount to be included in a currency budget. The staff felt that the amount of pounds sterling in the proposed operational budget was very reasonable. Sales of pounds sterling had been the second largest sales of any currency in the past year.

The Executive Board then turned to the proposed decisions.

The staff representative from the Treasurer's Department explained that in the proposed decisions on the designation plan and the operational budget for March-May 1982, the staff had introduced an explicit reference to a fact that had always been implicitly understood on previous occasions, namely, that in approving a new designation plan and operational budget, the Executive Board was in effect approving the list of members that were considered "sufficiently strong" under the provisions of the Articles. The reference had been included in the latest decisions because the text of a number of borrowing arrangements spoke of the transferability of claims to members that were judged sufficiently strong for their currencies to be sold under the operational budget, and it was felt that a clarification of precisely which countries those were at any particular time was needed. For that purpose, a reference to "the list of members considered sufficiently strong" in the proposed decision on the new operational budget would be sufficient and, strictly speaking, need not be included in the proposed decision for the designation plan. Accordingly, the words "the list of participants considered sufficiently strong" in the proposed decision for the designation plan for March-May 1982 could be deleted. Finally, the meaning of the proposed text of the decision on the operational budget would be clearer if the words "as set out in EBS/82/32, page 3, footnote 1," were added after the word "strong."

The Executive Board approved the proposed decisions as amended by the staff representative from the Treasurer's Department.

The decisions were:

Designation Plan for March-May 1982

The Executive Board approves the designation plan for the quarterly period beginning March 12, 1982 as set out in EBS/82/33.

Decision No. 7069-(82/28) S, adopted
March 12, 1982

Operational Budget for March-May 1982

The Executive Board approves the list of members considered sufficiently strong, as set out in EBS/82/32, page 3, footnote 1, and the operational budget for the quarterly period beginning March 12, 1982, as set out in EBS/82/32.

Decision No. 7070-(82/28), adopted
March 12, 1982

3. ZAIRE - 1981 ARTICLE IV CONSULTATION, AND USE OF FUND RESOURCES -
COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1981 Article IV consultation with Zaïre (SM/81/241, 12/15/81; and Sup. 1, 1/19/82) and a request from Zaïre for a purchase equivalent to SDR 106.9 million under the compensatory financing facility (EBS/82/27, 2/11/82). They also had before them a report on recent economic developments in Zaïre (SM/82/3, 1/11/82).

The Chairman commented that the Fund had not yet received a duly authenticated request from Zaïre to use the compensatory financing facility. The delay had been caused by a technical misunderstanding on the part of the authorities, and a proper request was expected in the Fund shortly. Accordingly, the Executive Board might wish to accept the proposed purchase under the compensatory financing facility in principle and to adopt a formal decision on a lapse-of-time basis, after the text of Zaïre's authenticated request had been circulated.

The staff representative from the African Department noted that, according to provisional figures, at end-December 1981 net domestic assets of the banking system had stood at Z 5,219 million and net credit from the banking system to the Government at Z 3,608 million.

Mr. Nana-Sinkam made the following statement:

I want to express my sincere thanks to the staff and management for the patience they have shown in handling the Zaïrian case. As usual, the staff reports are of an excellent quality, very concise, and give a pertinent analysis of the country's ongoing economic and financial situation.

The Zaïrian authorities are to be congratulated for implementing the different measures they have taken, particularly during the past three years. Some of these courageous measures have been implemented at considerable political risk. The authorities have had to struggle with a variety of adverse conditions, and there is no doubt that the realistic and flexible exchange rate followed has been a determining factor in bringing the rate of inflation down from more than 100 per cent in 1978 to around 35-40 per cent in 1981, although these actions have also caused a substantial decline in real wages. The cost of living adjustment in the public sector was held to only a fraction of the prevailing inflation rate, attributable mainly to shortages of imported goods and the large increases in many administered prices introduced as part of the 1981 financial program and price liberalization. The authorities are aware that it would not be easy to maintain much longer their restrictive wage policy, but it remains their firm commitment to do so.

There is no doubt that the authorities have made an important effort to handle the structural economic and financial difficulties facing them. The different measures taken are summarized in the staff papers on the Article IV consultation.

The country had taken these different measures despite two wars at its frontiers which have imposed considerable sacrifices on the country's relatively poor population. Few Fund member countries have experienced such a situation. In other circumstances, the situation of Zaïre in 1978-79 would have been considered an emergency one, since the wars took place in the copper region and caused the country to lose a highly important amount of export receipts, in addition to the human casualties.

Defending the case of Zaïre before this Board is always a challenge because every member of this Board is an expert on the economic and financial situation of this country. In fact, for the last six years, Zaïre has been closely in touch with our institution through different stand-by programs. Some of these programs have been successful, others have failed partially. I have used the word "partially" because the implementation of a program cannot be a complete failure. There are always some performance criteria which are respected and/or a useful lesson is always drawn from any failure! The concept of complete failure in the implementation of a program comes from our approach that considers programs successful only if all performance criteria are respected. This approach does not seem to be in tune with the basic principle that, once a program is set up, all inclusive performance criteria are of equal importance.

In terms of overall disequilibrium, we are presently, in relative terms, far from the situation that prevailed in 1978 and 1979. Although some sectoral disequilibria still persist, the rate of growth and magnitude of the disequilibria have been reduced. Saying that Zaïre has not respected all the performance criteria, and that those deviations from the agreed targets have triggered the suspension of its drawing right under the ongoing program, cannot be challenged; but what is interesting is the structural analysis of the nonobservance of the performance criteria.

The two tables attached show that the 1980 program was implemented with success. This achievement facilitated the successful negotiation of an extended Fund facility. In 1981, which was the first year of the extended arrangement, all performance criteria were respected up to June 1981. Unfortunately, Zaïre's considerable adjustment effort under the 1980 and 1981 programs was frustrated to a considerable extent by the severe and persistent decline in the terms of trade and the shortfall in capital inflows and budget revenues. Consequently, the picture became different in September and December 1981, and it can be shown that the reasons for the nonobservance of the program could be traced, at least partly, to unforeseen developments beyond the control of the Zaïrian authorities. In fact, out of the control of the authorities are the shortfalls in imports (loss of revenues from import taxes and from investment of imported capital goods through the tax multiplier), in export receipts, and in forecast capital inflows.

Because a major share of the fiscal receipts is derived from taxes on international trade, and because of the fall in the level of economic activity, total government receipts in 1981 were sharply below the program targets, notwithstanding the introduction of several important tax measures.

The authorities are aware that a relatively large budget deficit will place a heavy strain on the implementation of an effective monetary policy and will undermine the authorities' counterinflation efforts.

It is true, as stated above, that some of the major reasons behind these difficulties stemmed from considerations beyond the authorities' control. Nevertheless, the Zaïrian authorities have decided to continue their effort to reduce the budget deficit, reduce the proportion of the deficit financed by the domestic banking system, and curb the growth of domestic credit. This policy could create distortions and reduce the efficiency of resource allocation; hence, the authorities believe that the recent measures to decontrol interest rates and the associated increases in those rates should go a long way toward sustaining the Government's efforts. Needless to say, the failure to achieve the targeted level of exports has made it impossible for the authorities to reach the projected rate of real growth and has undermined the stabilization effort.

Despite the shortcomings, the Zaïrian authorities are committed to prudent economic management, as experience has shown that the country's economy is vulnerable to external conditions. The authorities' strong willingness and determination to pursue their efforts are demonstrated by the fact that they are expecting another Fund staff mission in the second half of this month to resume the discussions and to help them find an appropriate and workable solution to the difficulties they are facing.

Regarding the compensatory financing facility, the staff has done excellent work in giving convincing economic justifications for the shortfall, which is due to circumstances beyond the authorities' control. In fact, there has been an unforeseen and detrimental fall in the world price for copper. It has not been possible for the authorities to export their production of cobalt. In this field, the authorities are facing a painful situation in the sense that cobalt is a by-product of copper production and therefore its production cannot be controlled. In addition, on the cobalt market, we have a monopsony situation, in which many sellers are facing a single major buyer whose cobalt stockpile seems to suffice for its needs. It is forecast that, even if Zaïre were to reduce the price of cobalt from \$20 per pound to \$8 per pound, it would still not be able to export half of its cobalt production.

The staff has rightly stated on page 17 of EBS/82/27 that "the overall shortfall of SDR 215 million is attributable to circumstances largely beyond the control of Zaïre. In the light of the recovery projected, the staff also considers that the shortfall is temporary in character." Consequently, we will not insist further on the economic justification of the shortfall, since this has been done appropriately, and we want to extend our appreciation to the staff for a job well done.

However, it is rather surprising, indeed, to note that, out of a sound, consistent, and convincing economic argument, backed by a clear-cut balance of payments need and a seriously low level of foreign reserves, the staff drew a completely opposite conclusion, namely, the suggestion that the country cannot draw more than the equivalent of 50 per cent of its quota. The main reason advanced by the staff seems to be in the field of the member's cooperation with the Fund.

We believe strongly that the Fund should distinguish between the successful implementation of a program and the member's cooperation with the Fund. No one is questioning the fact that the extended Fund facility program with Zaïre was not a complete success in the second part of 1981. However, from there, it is difficult to draw the conclusion that Zaïre has not been cooperating with the Fund. Facts are available, and well known to the members of the Board, that support the conclusion that there has been close cooperation between Zaïre and the Fund. Let us just underline only a few of them:

a. Since 1976, Zaïre has been one of the few members that have maintained close contact with the Fund through different stand-by programs and consultation missions.

b. Since 1976, Zaïre, with the assistance of the Fund, has gone through two monetary reforms, with successive devaluations between 1980 and 1981 totaling more than 125 per cent vis-à-vis its major trading partners.

c. On the recommendation of the Fund, Zaïre has, in its Central Bank in Kinshasa, a team of six international experts provided by the Fund since 1979. The team is led by a "Principal Director" with decision-making power. There is also in the Ministry of Finance a team of fiscal experts led by a "General Controleur," also with decision-making power. In the Customs Department, there is another team in charge of monitoring the revenues from customs duties. There is no doubt that few member countries of this institution have experienced such close cooperation with the Fund.

In addition, we do not believe that the failure to appropriately implement a program is the most important aspect; rather, the acceptance or recognition of such failure by a country is more important. Such recognition is indicated by the country's willingness to continue

to cooperate with the Fund to find an appropriate and workable solution to its prevailing difficulties. At no time has Zaïre failed to recognize the partial failure in the implementation of a program, when this has been the case, and to show its strong willingness to resume discussions with the Fund in search of solutions to the country's problems.

Consequently, concluding that Zaïre has failed to cooperate with the Fund can only be a matter of judgment that can be questioned. It can be argued that the failure to hold down to the projected level of fiscal expenditure, because of the creation of a new public enterprise and an increase in the expenditure, by some government departments, such as education, has jeopardized the outcome of the implementation of the program. However, it might be useful to insert this fact into the general picture of the country's strenuous efforts.

The objectives of the program, the basic assumptions, and the performance criteria are stated in the different staff papers related to the Article IV consultation and in the compensatory financing facility paper, and are summarized in the attached two tables. The forecast level of imports has failed to materialize; the same is true for the projected export level, the inflow of capital forecast, the level of government revenues, the level of government expenditures, and, consequently, the budget deficit.

The staff seems to forgive its own errors, as its forecast level of imports, exports, capital inflows, and government revenues (which are all considered out of the control of the authorities) have not been achieved, but go on to condemn the Government for its failure to meet the expenditure target, which the staff considers as a failure to meet the test of cooperation with the Fund. We have our own doubts regarding this procedure and believe that the country should have been given the benefit of the doubt in the staff judgment since, in the final analysis, it seems to raise the kind of difficult question characterized by the old question of which came first, the chicken or the egg?

Furthermore, the Fund is condemning a country that has tried, with Fund assistance, to adjust and has failed but is still showing its willingness to resume as quickly as possible the discussions to find workable and appropriate solutions to its problem. In the meantime, there is a tendency to favor countries that have not yet decided to seek Fund assistance for adjustment process and that have no experience with the painful adjustment exercise and the agony of defeat in the implementation of an adjustment program. In fact, those countries can benefit by receiving a 100 per cent drawing under the compensatory financing facility with one major proviso, namely, their intention to cooperate with the Fund, and provided they have indicated a set of measures, leaving the impact of such measures to the staff's judgment. This procedure leads to

extending to the country concerned the maximum benefit of the doubt. There is nothing wrong with that approach, but our concern is whether we are treating others, such as Zaïre, appropriately or on the basis of a flexible application of the principle of equal treatment to members.

Another aspect of this case has struck me. Paragraph 29 of EBS/81/251, on the compensatory financing facility, "Experience with the Requirement of Cooperation," to be discussed on April 2, 1982, reads:

The greatest difficulty in the application of the requirement of cooperation in connection with upper tranche CF purchases relates to CF requests made by members whose drawing rights under an existing arrangement have been interrupted because of nonobservance of the performance criteria. A large variety of circumstances characterizes these cases and it is not possible to subsume them in any single category. In many cases, discussions are under way with the member at the time of a CF request with a view to identifying the sources of the difficulties and ultimately reaching new policy understandings aimed at the resumption of purchases under the existing arrangement or obtaining a new arrangement. Depending on the circumstances of the case, it might be desirable to postpone a CF request until the discussions have been completed. Of course, satisfactory conclusion of the negotiations would represent evidence of the required cooperation. In cases where negotiations are not in progress, the judgment on cooperation needs to be made on a case-by-case basis, in order to determine the nature of the difficulties that led to the interruption of the right to purchase under the arrangement and, more generally, the appropriateness of the member's policies.

The second part of paragraph 27 of the same document reads:

It is suggested that the existence of and satisfactory performance under a financial arrangement at the time of the CF request should continue to be considered to provide evidence of cooperation, without implying in any way that the existence of such an arrangement is a prerequisite.

Furthermore, the second sentence of paragraph 23 states that:

The CFF decision does not create a presumption that changes in the policies are required to meet the requirement of cooperation for the use of the upper tranche.

Although there seems to be some contradiction between those different statements, one has the impression that the treatment of Zaïre's case is a clear application of the content of the above-mentioned paragraph 29. If that is the case, it only indicates that the staff is presenting the Board with a "fait accompli" in the sense that the Board will be told on April 2 that it is approving de jure a decision which has been already applied de facto.

I know that rules and laws can be construed in that manner, but I do not believe that this would be a fair practice in this institution, taking into account the sensitivity of Fund decisions for member countries. I therefore hope that this has been only a very regrettable coincidence.

Very often in dealing with the different cases facing the African countries in particular, one cannot but feel very powerless. Many questions come to mind: Why are the adjustment efforts undertaken by those countries failing one after another? Are we not asking more from them than they can effectively deliver? Is the speed of adjustment suggested realistic? Are we giving appropriate weight to externalities in the formulation of our recommended adjustment programs? Should we not be better off with the gradual approach versus the shock approach often suggested? These questions as well as others cannot be easily answered. Nevertheless, they are legitimate questions and our institution should try to answer them for they will continue to be raised.

We know we are in a dilemma; world economic and financial turmoil is making the imbalances larger and larger. Consequently, the macroeconomic policies that used to be sufficient in the case of smaller size adjustments, are becoming inefficient with the emergence of distortions that call for the adoption of microeconomic or more specific measures. Unfortunately, the distortions are more often from external shocks, beyond the control of the authorities. Under those circumstances, microeconomic measures are inefficient as the external responses cannot be forecast with accuracy. We may have to reshape our thinking.

In concluding, we may assume that as soon as the expected negotiations by the Fund mission due in Kinshasa in April lead to a new program, Zaïre will be automatically qualified to draw the balance of 50 per cent under the compensatory financing facility.

Table 1. Zaïre: Credit Performance

(In millions of zaïres)

	1980				1981			
	March	June	Sept.	Dec.	March	June	Sept.	Dec.
Net assets of banking system								
Ceiling	3,027	3,192	3,431	3,596	4,128	4,300	4,500	4,700
Actual	2,934	3,136	3,534	3,400	4,054	4,242	4,623	...
Net credit to Government								
Ceiling	2,173	2,303	2,417	2,502	2,924	3,029	3,104	3,179
Actual	2,013	2,060	2,284	2,329	2,924	2,907	3,192	3,779*

* As of the end of November 1981.

Table 2. Zaïre: Performance

	1980			1981		
	Target (1)	Actual (2)	Difference (2-1)	Target (3)	Actual (4)	Difference (4-3)
(In millions of SDRs)						
Imports	1,091	923	-168	1,042	911	-131
Exports	1,747	1,502	-245	1,503	1,255	-248
Capital inflows	137	292	+155	290	210	-80
(In millions of zaïres)						
Budget						
Revenue	3,260	4,186.6	+926.6	5,817	5,500	-317
Expenditure	3,740	4,331.8	+591.8	6,367	6,775	+408
Deficit	480	145.2	-334.8	550	1,275	+725
(In per cent)						
GDP						
Budget deficit as a percentage of						
GDP	2	0.8				
Revenue	14.72	3.0		9.0	23.18	

Sources: EBS/81/126; SM/81/241 and Sup. 1; and SM/82/3.

Mr. Connors remarked that the proposed purchase under the compensatory financing facility presented a problem for him, as he doubted whether a sizable part of the export shortfall calculated by the staff was attributable largely to circumstances beyond the control of the authorities. The shortfall in cobalt exports accounted for a major proportion of the total export shortfall calculated by the staff. However, given Zaïre's marketing strategy and pricing policies for cobalt during the past few years, the cobalt shortfall should not be included in the calculation of the total shortfall. The staff had explained in some detail why it felt that the shortfall in cobalt exports had been largely beyond the control of the authorities in 1981, but by concentrating on Zaïre's policies in that year the staff had not given sufficient weight to the impact of Zaïre's pricing policies in 1979 and 1980 on its cobalt exports in 1981.

Zaïre's pricing and export policies in 1979 and 1980 appeared to have contributed to the decline in world demand for cobalt in 1981 resulting from the substitution away from cobalt, Mr. Connors continued. The relative price of cobalt had undoubtedly played a role in the substitution, and there was some evidence that Zaïre's export and pricing policies in the period 1979-81 had contributed to the decline in the country's relative share of the reduced total world demand for cobalt in 1981.

On page 11 of EBS/82/27, Mr. Connors went on, the staff had explained that Zaïre had "resisted raising its prices in line with the much higher price (of \$50 per pound) reached on the free market at the height of the crisis in the first quarter of 1979. It is reasonable to conclude that, while its aim was to maximize earnings, Zaïre was also conscious of the adverse effects of high prices on long-term demand for the metal." He was concerned mainly about Zaïre's export and pricing policy during most of 1979 and 1980. Table 5 showed that the volume of Zaïre's cobalt exports had dropped by 20 per cent in 1979 and 33 per cent in 1980, while its cobalt stocks had increased by more than 10 per cent in 1979 and in excess of 40 per cent in 1980. It was clear that Zaïre could have discouraged substitution to other metals by exporting more cobalt than it actually had in 1979 and 1980, a move which, in view of Zaïre's dominant market position, would have resulted in lower world prices for cobalt than had actually been the case.

He agreed with the staff, Mr. Connors continued, that the major reason for the weak demand for cobalt in 1981 was the slowdown in world economic activity, but the decline had been exacerbated by the sustained high prices for cobalt in 1979 and 1980. Although there was evidence that Zaïre had priced its cobalt exports slightly below the spot market prices in 1979, the country could have contributed to a more rapid return of market prices to pre-1978 levels if it had followed more aggressive export and pricing policies. After all, Zaïre was the dominant world producer of cobalt, accounting for more than 40 per cent of total world output.

Available price data, Mr. Connors noted, suggested that in 1980 and 1981 Zaïre had priced its cobalt exports above the spot market price, thereby contributing to the decline in its relative share of the world market in late 1980 and in 1981. In an effort to recover some of that share, Zaïre had apparently found it necessary to reduce its price in 1981 and early in 1982. Complete data were not yet available, but in all likelihood Zaïre's share in world cobalt markets had shrunk in 1981. Since the United States was the world's largest importer of cobalt and Zaïre was the world's largest exporter, changes in Zaïre's share of the U.S. market were probably indicative of what had happened to Zaïre's share of world markets. Zaïre had supplied 44 per cent of total U.S. cobalt imports in 1979 and 38 per cent in 1980; in 1981, Zaïre had accounted for just over one fourth of U.S. imports of cobalt. Zaïre's share of the U.S. market had been reduced in 1981 because of Zaïre's pricing policy, a policy that other producers--which had increased their market share at Zaïre's expense--had chosen not to follow. In evaluating Zaïre's request Executive Directors would benefit from further information on the behavior of Zaïre's shares in the cobalt markets in addition to those in the United States.

The staff's calculation of Zaïre's total export shortfall was SDR 214.9 million, Mr. Connors noted, and acceptance of the proposed purchase under the compensatory financing facility of SDR 106.9 million would keep Zaïre's total drawings under the compensatory financing facility from exceeding 50 per cent of quota. When cobalt exports and cobalt export variability were excluded from the calculations, Zaïre's export shortfall was in the range of SDR 93-95 million, figures that were reasonably close to the proposed purchase. There might well be some other ways to adjust for the developments with respect to cobalt, and he did not wish to make a proposal for reducing the size of Zaïre's purchase. The Executive Board was scheduled to review soon the general policy on a shortfall that was largely attributable to circumstances beyond the control of a member, and he hoped that some of the issues that he had raised at the present meeting with respect to the specific case of Zaïre could be addressed at that time. That occasion would also be an appropriate one on which to consider the issue of cooperation which Mr. Nana-Sinkam had raised in his opening statement. In his view, the staff had correctly applied the test of cooperation to the present case of Zaïre.

He generally agreed with the appraisal in the staff report for the 1981 Article IV consultation with Zaïre, Mr. Connors said. Although some progress had been made, it was unfortunate that Zaïre had been unable to perform better than it actually had under the extended arrangement with the Fund. Certain exogenous factors had contributed to the basically poor performance, but there had also been shortcomings in policy implementation. In particular, excess government expenditure had been a problem since mid-1981, especially in the areas of education, defense, and presidential allowances; those expenditures had not been economically efficient and had certainly been ill-advised. The authorities should increase their efforts to control such expenditures, and a

high priority should be given to implementing the plan for rehabilitating GECAMINES; the authorities should continue to work closely with the World Bank in implementing the plan. Mining was a fundamental part of the economy, and it was essential that the mining sector be managed efficiently, and that the goals for restoring mining production be met.

The authorities were to be commended, Mr. Connors considered, for introducing more flexibility than hitherto in the interest rate, pricing, and exchange rate policies. He was pleased that the authorities intended to maintain flexibility in those areas; indeed, it would have to be maintained if Zaïre was to be able to respond quickly to economic developments.

Mr. Kohnert recalled that, during the discussion on the proposal for approving an extended arrangement for Zaïre (EBM/81/94, 6/22/81), most speakers had said that the authorities had performed well under the expired stand-by arrangement. They had noted that all the performance criteria for 1980 had been met and that the authorities had implemented courageous measures, such as the elimination of price controls, increases in interest rates, and a substantial devaluation of the zaïre. As a result, there had been a noticeable improvement in economic activity in the first months of 1981 after several years of stagnation, and most Executive Directors had expressed the opinion that the time was ripe for a longer-term program to support Zaïre's effort to achieve sustainable economic growth. Speakers had mentioned that the economic situation would remain delicate for some time, because the recovery would depend to some extent on factors that were mainly beyond the control of the authorities. They had stressed the need to avoid slippages in the implementation of adjustment policies--which were, after all, directly subject to the authorities' control--and especially budgetary policy.

Unfortunately, Mr. Kohnert continued, slippages had actually occurred, especially with respect to expenditures for the presidency, defense, and education. As a result, the credit ceilings under the program had not been observed; and the departures from the ceilings would have been greater in the absence of the accumulation of domestic and foreign payments arrears. The system of quarterly reviews of, and targets for, public expenditures--which had been established in the first half of 1981--apparently had not been very effective. It would be useful to receive a further comment on the effect of the expenditure overruns on the monetary aggregates and inflation, the tax reform that was expected in 1982, and the proposed reforms of the management of the public enterprises.

Although the overall performance had been less favorable than had been expected, Mr. Kohnert commented, some progress had been made: there had apparently been improvements in the transportation sector, which had been a major bottleneck in the past; cotton production had increased; and the authorities had reaffirmed their commitment to solving the budgetary problems. However, much still had to be done to repeat the promising economic performance recorded in 1980, as Zaïre continued to face the old

problems of an entrenched balance of payments crisis and fragile public finances. Accordingly, the policy advice that the Executive Board had offered in 1981 remained fully relevant.

Commenting on the proposal for using the compensatory financing facility, Mr. Kohnert said that present copper prices were low--lower, indeed, than the average price in the preceding year. The price on March 1, 1982 had been \$0.75 per pound, and the price for futures contracts in the period March-May 1982 showed a further weakening, to \$0.67-0.71 per pound. The price in the futures market was generally an indicator of the price that was likely to be obtained in the coming period. The staff had assumed that the price of copper would increase from an average of \$0.77 in 1981 to \$0.88 in 1982. If, as seemed possible, the price of copper remained weak--in the range of \$0.70 to \$0.75 per pound--until mid-1982, the price would have to average about \$1.00 per pound in the second half of 1982 if the staff's assumption was to be borne out in fact. Accordingly, the price of copper would have to peak at a level considerably in excess of \$1.00 at the end of 1982.

He understood the reasons why the staff felt that there would be a substantial rise in the price of copper in the coming months, Mr. Kohnert remarked, but the staff's price projections seemed to be on the high side. In recent months the prices for Zaïre's raw material exports had had to be reduced on several occasions, and an unexpectedly slow recovery of export receipts in coming months could cause the authorities to make incorrect decisions on the budget. Conservative estimates would in fact be a more favorable approach for a fragile economy like Zaïre's, even if they involved a smaller calculated shortfall than would otherwise be the case.

The enormous increases in the price of cobalt in 1978 and 1979 had encouraged the users of the metal to intensify their search for cobalt substitutes, Mr. Kohnert noted, and nickel and chromium were now used instead of cobalt in a wide range of industrial enterprises; and the switch seemed to be irreversible, not temporary. In consequence, the shortfall in cobalt exports might well not be temporary in nature. The staff had assumed that there would be a further decline in the value of cobalt exports in 1982 followed by a sharp pickup in export receipts in 1983, due mainly to a 50 per cent rise in the volume of cobalt exports. Table 4 in EBS/82/27 showed that the staff had assumed that the volume of cobalt exports would double in the two postshortfall years. On the other hand, the staff had stated on page 17 that there would be only a gradual recovery in demand.

On January 11, 1982, Mr. Kohnert said, the German Economic News Agency had reported that the authorities in Zaïre and Zambia had agreed in Lusaka not to sell cobalt for less than \$17.50 per pound, compared with the world market price of about \$13 per pound. The staff had mentioned on page 8 of its report (SM/81/241) that the authorities had had reservations about undertaking a sales promotion effort and had preferred further to increase their stocks. Hence, he wondered whether it was correct to say that the shortfall in cobalt exports had been beyond the

control of the authorities, and he looked forward to hearing the staff response to the issues that Mr. Connors had raised. In the period 1978-80, Zaïre had expanded production of cobalt by 10 per cent but had considerably reduced exports from the level of 15,000 tons in 1978, when prices had reached a peak in response to the crisis in Shaba Province. Only 8,000 tons of cobalt had been exported in 1980, and 4,500 tons in 1981. The weakening of the world economy had undoubtedly contributed to the decline in Zaïre's sales of cobalt, but Zaïre's share in world exports of cobalt had fallen from 44 per cent in 1978 to about 30 per cent in 1980, according to estimates provided by his authorities. Had the authorities in Zaïre attempted to maintain world prices by building up huge stocks of cobalt? In any event, Zaïre's cobalt offered price had consistently been much higher than the average price on the world market; for instance, in December 1981, the market price had been in the range of \$8.50-9.70 per pound, while Zaïre's offered price had been about \$17.00. Moreover, the German Economic News Agency had reported on December 17, 1981 that the world price of cobalt could increase to \$15.00 if Zaïre continued to maintain its cautious export strategy.

Zaïre had occasionally lowered the price of its cobalt exports, Mr. Kohnert remarked, mainly because, as the staff had explained on page 38 of SM/82/3, "of the continuing weakness in foreign demand and the need to slow down research into substitutes." It could be argued that Zaïre's strategy had contributed to the shortfall in cobalt exports; that view was shared by experts in other international organizations. Still, even if cobalt exports were not taken into account, the range of permissible drawings under the compensatory financing facility would include the proposed purchase. In negotiating the proposed drawing the staff had been justified in keeping Zaïre's drawings under the compensatory financing facility from exceeding the equivalent of 50 per cent of quota.

Mr. de Groote remarked that the staff had described in a balanced way the constraints of the Fund-supported program--whose aims might have been excessively ambitious--and the shortcomings in the Government's economic policy management. The staff papers on Zaïre brought to mind a number of questions that had a bearing on that country as well as on certain other recent cases. For instance, had the implementation of the adjustment effort been undermined by the suspension of the drawings under the extended arrangement? Would the Fund's leverage on Zaïre's policies not have been enhanced by the timely readjustment of the performance clauses in response to the changing circumstances? Had the interruption of financing under the extended arrangement not caused Zaïre to lose the chance to benefit from the deflationary policies that could have paved the way for a recovery of income?

A number of those questions had been addressed by Mr. Nana-Sinkam in his opening statement, Mr. de Groote continued. He fully agreed with Mr. Nana-Sinkam that unforeseen developments beyond the control of the Zaïrian authorities had accounted to a large extent for the nonobservance of the performance criteria and justified the proposed purchase under

the compensatory financing facility. The data that Mr. Nana-Sinkam had provided clearly showed that the amount by which the performance criteria had not been observed was accounted for almost precisely by shortages in revenue due to the acceleration in the deterioration in the terms of trade and the unexpectedly small inflow of capital. It was important to bear in mind that the overall government deficit, which had been 15 per cent of GDP in 1976, was now no more than 5 per cent of GDP, and that total government expenditure had fallen from 37 per cent of GDP in 1975 to 25 per cent in 1981, an exceptionally low figure for a developing country that had a major need for financing for the development of its infrastructure.

The very limited expansion of total domestic credit under the successive Fund programs from 1977 to 1981 was an indication of their restrictiveness, Mr. de Groote continued. Expressed in U.S. dollar terms so as to reflect that movement in approximate real terms, total domestic credit had increased somewhat in 1977-79 and had then fallen by 20 per cent in 1979-81; the fall was particularly striking in the light of the exceptionally large recovery needs facing the economy. Even more worrying was the fact that the rate of growth of credit to the public sector had been reduced by only 5 per cent in 1979-81, as the small reduction implied a systematic crowding-out of the private sector when the opposite should have been the case. The performance criteria for Zaïre had been moderately expansionary in the years 1977-79 and quite restrictive in 1980-81, when the World Bank and Zaïre's creditors had recognized that adjustment would have been possible only in an expansionary environment.

The main cause of the nonobservance of the performance clauses in the second half of 1981, Mr. de Groote considered, was the unsustainability of the credit ceilings following the reduction in government receipts due to external factors. In any event, the credit ceilings had proven to be incompatible with the longer-term requirements of a developing economy like Zaïre's. The nonobservance had harmed Zaïre's creditworthiness and undermined the efforts to renegotiate its foreign debt. While it had appeared that Zaïre had performed poorly under its arrangement with the Fund, the fact was that the country had been penalized for having accepted credit ceilings that had obviously been excessively low and rigid at the outset; under the prevailing world market conditions, the ceilings could have been observed only at the cost of an intolerably high rate of inflation in Zaïre.

The intention of the authorities to resume negotiations on a new Fund-supported program in April 1982 was certainly welcome, Mr. de Groote remarked, as it clearly showed their intention to continue cooperating with the Fund. The ceilings under the new program should be compatible with the long-term needs of the country. As the period of economic reorganization and containment had almost come to an end, the effort to collect sufficient government receipts and to limit inflation would have to be based on an expansion in income. The staff had described the main objectives that should be included in a new financial program; all of them had been favored by the authorities themselves at the time of the

establishment of the present three-year arrangement with the Fund. The priority objectives included a further liberalization of the price system in order to enhance production incentives, a liberalization of import licensing and controls to improve the allocation of foreign exchange, a restoration of the internal transport network to facilitate sales and exports of agricultural products, the introduction of a flexible exchange rate policy, and the reorganization of the financial management of the mining sector, so that it would continue to be a growing source of revenue for the Government and would help to strengthen the balance of payments.

Commenting on Zaïre's request to use the compensatory financing facility, Mr. de Groote said that he saw no justification for accepting the argument by previous speakers that the stocks of cobalt were grounds for revising the staff's figure for the total export shortfall. Cobalt was produced only as a by-product of copper; accordingly, decisions on production were meant to increase or reduce the output of copper, not cobalt. The main marketing decision with respect to cobalt was whether to sell at any price the cobalt that had been accumulated as a result of the production of copper, or whether the cobalt should be kept until market conditions improved. Another important factor was that the market for cobalt was clearly monopsonistic: there was only one dominant purchaser, namely, the U.S. Government, which needed cobalt for its strategic stockpiles. Accordingly, it was difficult to show that, by reducing the price that it charged, Zaïre would have necessarily reaped an increase in total receipts from cobalt sales which was proportionately greater than the price reduction. Monopsonistic market conditions typically were not characterized by any significant degree of price elasticity of demand; the quantities that were purchased by importers usually were not determined on the basis of price considerations. Instead, purchases were made when the United States felt that it needed to increase its stockpile of cobalt for strategic purposes. It was true that the high price of cobalt had encouraged substitution by importers, and that the substitution represented an irreversible change in market conditions, but it was still also true that the amount of cobalt that Zaïre sold to the United States was determined by noneconomic factors. In those circumstances, selling cobalt at a relatively low price would have certainly been inappropriate; it would have reduced the chances for benefiting from any future increase in the strategic demand for cobalt.

In his opening statement Mr. Nana-Sinkam had raised an important question of principle having to do with Zaïre's access to the compensatory financing facility, Mr. de Groote continued. Mr. Nana-Sinkam had made an impressive argument for revising the staff's proposal for limiting Zaïre's total access at the present stage to 50 per cent of quota; he had clearly shown that Zaïre had not failed to maintain a satisfactory degree of cooperation with the Fund. By limiting Zaïre's access to the compensatory financing facility at the present time, the Executive Board would in effect be applying to Zaïre a policy that had not yet been fully accepted by the Board. Because Zaïre planned to resume negotiations with the staff in April 1982 and intended to continue implementing the financial program under the extended arrangement, the Executive Directors

should consider the possibility of not waiting until the negotiations began before making the equivalent of another 50 per cent of quota available to Zaïre under the compensatory financing facility. That decision could conceivably be taken at the present meeting.

Mr. de Maulde stated that he broadly agreed with the staff appraisal in SM/81/241, although he would place even more emphasis than the staff on the fact that the difficulties that the authorities had had in implementing the Fund-supported financial program had been traceable mainly to exogenous factors. Still, although many adjustment measures had already been implemented, the economic and financial situation in Zaïre clearly continued to be precarious.

One aspect of the balance of payments--private capital and other outflows--had been unexpectedly favorable, Mr. de Maulde noted. It would be useful to receive further information on that development.

Commenting on fiscal policy, Mr. de Maulde said that he fully agreed that further strong action might well be needed on both the revenue and expenditure fronts, and he wondered whether the staff had not been somewhat optimistic in its revenue projections. On page 13 of SM/81/241 it was said that considerable revenue could also be mobilized by a more determined application and administration of existing tax legislation. That description might well fit a number of member countries, including some industrial countries and, in any event, improvements in tax administration were known to be painfully slow. Although there was certainly room for improving the efficiency of the tax system in the medium term, the higher priority in the short run should be given to enhancing expenditure control.

In the monetary field, Mr. de Maulde continued, the main problem had obviously been the need to increase net credit to the Government as a result of the tax revenue shortfall. Apparently credit to the private sector had been brought back on track by the end of 1981, after having grown at an excessively rapid rate in the first half of the year. Was it correct to conclude that the liquidity problems facing firms in the first half of 1981 had somehow been solved by the end of the year? Had administered prices been allowed to rise in a sufficiently flexible way? The rapid increase in the category "other net domestic assets" had been caused by a variety of factors, including the so-called remonetization process and the reduction in the level of deposits that banks were required to hold in reserve. Did the trend of "other net domestic assets" call for any action by the monetary authorities?

Commenting on Zaïre's relations with the Fund, Mr. de Maulde said that the country's external payments position had not met expectations mainly because of the large shortfalls in export earnings and capital inflows. The volatility of commodity prices had added to the difficulty in managing the economy, and there was always great uncertainty about the likely behavior of the international banking system toward a country that had benefited from debt rescheduling. The economic forecasts that

the staff had made in June 1981 had certainly seemed reasonable at the time, but it was clear now, with the benefit of hindsight, that they had been much too optimistic.

It seemed reasonable to conclude, Mr. de Maulde went on, that the Fund as well as the Zaïrian authorities should be expected to deal with the consequences of the excessively optimistic forecasts. It would be unreasonable either for the Fund to ignore realities by refusing to revise the forecasts on which the extended arrangement was based, or to expect that a multiyear arrangement could be implemented in an extremely volatile international economic environment without any modification of the quantitative targets. The case of Zaïre clearly showed the need for the Fund to re-examine its present practices with respect to multiyear arrangements with member countries. A country should certainly be expected to adopt additional adjustment measures when the external environment changed significantly; at the same time, however, the Fund should be expected to review its approach to its arrangement with the country. Quantitative performance criteria were certainly appropriate for an adjustment program, but the success of the program depended as much on qualitative factors as on quantitative ones. In a case in which the exogenous factors facing an economy had been less favorable than the Fund had forecast, the institution should ensure that the country's policies were in the right direction and that the pace of adjustment was reasonable rather than insist on sticking to quantitative performance criteria that were no longer feasible.

The case of Zaïre also suggested that, if a country had been unable to meet all of the performance criteria because of exogenous factors, a new, shorter arrangement with the Fund might well be called for, Mr. de Maulde remarked. The reasons why Zaïre had been thought to be eligible for an extended arrangement were still valid: the growth of GDP had stagnated since 1975, and strong supply-side measures were still clearly needed. Although the pace of implementation of the adjustment program and the program details should be reviewed, the basic medium-term strategy was still valid. It might be more efficient to resort to a bridging operation in the form of a short stand-by arrangement than to revise the economic and financial program for the second year of the extended arrangement.

He fully agreed with Mr. de Groote's comments on Zaïre's request to use the compensatory financing facility, Mr. de Maulde said. As Mr. Nana-Sinkam had stressed, the staff had failed to explain why it felt that Zaïre had not met the test of cooperation for a drawing in the upper tranche. He looked forward to the scheduled review by the Executive Board of the issue of cooperation and would have more to say on the matter at that time.

The case of Zaïre suggested that the Fund should consider in the near future another general policy matter: how to offset in an efficient manner the wide fluctuations in the prices of commodities, Mr. de Maulde remarked. The use of the Fund's buffer stock financing facility had

been distressingly limited: total drawings under the facility had amounted to less than SDR 104 million. A number of member countries in addition to Zaïre faced serious difficulties because of the fluctuations in the price of raw material exports; the reasons for the limited use of the buffer stock financing facility probably had more to do with the provisions of the decision governing the facility than with the lack of demand for such assistance by member countries.

Mr. Joyce said that Mr. Nana-Sinkam had raised a number of fundamental issues concerning the basic policies and practices of the Fund, and its relations with Zaïre. Zaïre's present economic situation naturally brought to mind a number of critical issues having to do with the impact of the world economy on Zaïre, and particularly the ability of the authorities to match their determination to act with the actual implementation of required measures.

During the previous discussion on Zaïre, Mr. Joyce recalled, Executive Directors had recognized that Zaïre faced serious problems, though the economy had started to grow again in 1980, and the authorities had adopted a number of measures that had already resulted in an increase in government revenues, a reduction in arrears--albeit through a rescheduling of Zaïre's debt--and a reduction in the budget deficit as a proportion of GDP. Despite those important improvements, there had clearly been some worrying signs, including the continued high rate of growth of government expenditure, and the further deterioration in the terms of trade, which had intensified balance of payments pressures. Indeed, there had already been some evidence of slippage in the government deficit in early 1981, and the authorities had been prompted to adopt new revenue and expenditure measures and to promise that they would take additional steps, for instance, the establishment of quarterly targets for total expenditures in some of the traditional problem areas, such as defense and education.

In fact, Mr. Joyce went on, the shortfall in export earnings had been larger than had been forecast, capital inflows had been smaller, and the overall balance of payments deficit had been larger, thereby causing a serious deterioration in tax revenues; two thirds of the revenue shortfall was attributable to the decline in tax revenues derived from international trade. At the same time, there had been considerable overshooting of the expenditure targets, thereby leading to unexpectedly large increases in the government deficit and net borrowing from the domestic banking system, a rise in the level of arrears, and failure to meet the performance criteria under the extended arrangement.

To a considerable extent, Mr. Joyce commented, the poor performance had been attributable to the deterioration in Zaïre's international trading position despite both the devaluation of the zaïre in 1981 and the authorities' efforts to deal with the problems caused by the decline in the price of cobalt. In those circumstances, the authorities could have reasonably been expected to have made smaller and more timely adjustments in the exchange rate and to have exercised even more restraint on

expenditures than had originally been planned. In fact, they had clearly failed to exercise effective restraint on expenditures; outlays for the presidency had roughly doubled, the disbursements on education had been unexpectedly large, and the granting of an import monopoly to a state-owned enterprise had required a major capital injection. It would be useful to receive further comments by Mr. Nana-Sinkam and the staff on the extent to which Zaïre's failure to meet the performance criteria was attributable to the international economic situation as opposed to the authorities' inability to fulfill its intention of restraining expenditure. The answer to that question had an important bearing on the appropriate policy mix in the coming period. What were the prospects for bringing the present economic and financial program back on track? The chances seemed to be quite limited, and the next staff mission might well have to consider other options, such as a new stand-by arrangement.

The authorities in Zaïre obviously could not be expected to provide guarantees that were based on future developments in the international economy, Mr. Joyce continued, but they could provide guarantees with respect to their determination to control expenditures, particularly in the crucial areas of the presidency and education. The need for such control was particularly great in light of the anticipated continued revenue shortfalls. That the key expenditure fields had not been well controlled despite the provision of technical assistance in the monetary and fiscal fields and the introduction of control measures was particularly disappointing.

He wondered how donor countries would respond to Zaïre's present economic situation, Mr. Joyce remarked. Could they be expected to continue to provide aid to Zaïre? Were governments and commercial banks prepared to consider a further rescheduling of Zaïre's international obligations?

It would be useful to know, Mr. Joyce said, whether the staff had any additional information on the authorities' intention--originally expressed in June 1981--to implement effective tax reform in 1982. That question and the others that he had raised were admittedly difficult to answer, but they had much to do with the prospects for Zaïre's economy. Zaïre was well endowed with natural resources and was a potentially rich country. His authorities sympathized with the authorities in Zaïre, who had encountered a number of difficulties, including the security problems that Mr. Nana-Sinkam had mentioned in his opening statement. They appreciated the steps that the Zaïrian authorities had already taken with respect to interest rates, administered prices, and the exchange rate, and they understood the frustration that the Zaïrian authorities had felt in the face of recent developments in Zaïre's export markets. Still, the kinds of issues that he had raised would have to be resolved by the authorities if they were to deal successfully with the difficulties facing the economy.

He had no difficulty in accepting in principle Zaïre's request to use the compensatory financing facility, Mr. Joyce remarked. The staff's calculation of the export shortfall seemed appropriate, and its copper price projections did not seem excessively high, particularly in comparison with the even more optimistic projections by others, such as the World Bank and the staff of Case Econometrics. He agreed with the staff that the accumulation of cobalt stocks in the export shortfall year had not caused earnings from cobalt exports to decline in that year.

He, like Mr. Nana-Sinkam, felt that it was unfortunate that the issue of Zaïre's cooperation with the Fund had arisen before the Executive Board had been able to review the general policy questions concerned, Mr. Joyce commented. Mr. Nana-Sinkam had usefully noted that countries with Fund-supported programs felt that they were analyzed more stringently under the test of cooperation than countries that had not undertaken such programs. Moreover, it was inappropriate to assume automatically that, if drawing rights under an existing arrangement had been interrupted because of nonobservance of performance criteria, the member was not necessarily cooperating with the Fund. The staff itself had concluded that nonobservance of performance criteria was associated with a wide variety of circumstances, and that instances of nonobservance should be dealt with on a case-by-case basis. On the other hand, it was reasonable to presume that a country would have to introduce new measures in order to bring its Fund-supported program back on track no matter what the initial causes of the nonobservance of performance criteria might have been. Cooperation with the Fund implied, at the least, that the Fund and the authorities concerned were actively discussing appropriate policy measures, and that the Fund was satisfied that, even if agreement on the measures had not yet been reached, it soon would be. In that connection, further comments by Mr. Nana-Sinkam and the staff on the situation with respect to Zaïre would be helpful.

In his opening statement, Mr. Joyce concluded, Mr. Nana-Sinkam had raised the possibility of permitting Zaïre to draw the equivalent of an additional 50 per cent of quota under the compensatory financing facility in the coming period if the Executive Board decided that Zaïre met the stricter test of cooperation. Such a decision would have to be taken in the light of the information that was available at the time.

Mr. Taylor said that he was disappointed that Zaïre's extended arrangement had had to be interrupted after the encouraging progress that had been made in 1980 and 1981. The progress had been due in part to cyclical factors, but the constructive measures that the authorities had introduced under the earlier stand-by arrangement had also played a role.

In recent months, Mr. Taylor continued, the economy had suffered from adverse external developments, and particularly the weakening of its export markets. However, the staff had concluded that the deterioration in the economic situation in 1981 had been due in part to deficiencies in policy implementation, and he hoped that that development did not imply that there had been a softening of the determination of the authorities

to continue the adjustment effort. In some respects the authorities had restored stability to the economy, but the external position was still far from being sustainable.

There were serious structural imbalances in Zaïre's economy, Mr. Taylor commented, and a major and sustained effort to correct them was clearly required. The objectives and the thrust of the original adjustment program supported by the extended arrangement were still valid, especially the supply-side measures.

Mr. de Groote's comments on the tightness of the targets under the extended arrangement were striking, Mr. Taylor went on. With the benefit of hindsight, the targets did indeed seem to have been somewhat rigorous, although that fact indicated that economic circumstances in Zaïre were particularly difficult to predict. In any event, there was a crucial need to diversify the economic base away from its dependence on a limited range of traditional minerals in order to reduce Zaïre's vulnerability to external developments. To that end, greater use than hitherto should be made of domestic resources. In the light of recent developments, particularly the very limited fiscal steps that had been taken, the immediate need seemed to be to achieve stability; therefore, he agreed with previous speakers that a one-year stand-by arrangement might well be preferable to revising the program for the second year of the extended arrangement.

Improved techniques for monitoring expenditure control seemed to be needed, Mr. Taylor said, and the authorities might well benefit from moving to a system of monthly--rather than quarterly--targets for key expenditure categories. If expenditure cuts had to be made, they should leave intact the public investment program designed to eliminate serious infrastructural bottlenecks.

The staff seemed to feel, Mr. Taylor noted, that the target for expenditure outlays in 1981 had been achieved at the cost of an accumulation of domestic arrears. Did the staff have any information on the magnitude of the existing arrears?

The staff reports contained little discussion of the public enterprises' financial position and the burden it had placed on the budget, Mr. Taylor remarked. The enterprises should set tariffs at economic levels, allowing a full and rapid pass-through of the cost increases arising, in part, from the large devaluation of the zaïre in 1981.

He agreed with previous speakers, Mr. Taylor said, that the tax collection procedures should be strengthened. Moreover, the staff had correctly stressed the importance of early adoption of an appropriate fiscal regime for GECAMINES. The need for prompt action in those areas was underscored by the staff's feeling that the official projection of revenues in 1982 might have been overestimated.

The staff's reports contained only a brief discussion of monetary policy, Mr. Taylor noted, and he wondered whether the staff felt that there was only a small role to be played by a tightening of monetary policy. The heavy borrowing by the Government from the banks and the serious shortage of liquidity in the industrial sector suggested that there might well not be much room for tightening monetary policy. However, interest rates had remained substantially negative in real terms, and a case could perhaps be made for a further increase in real interest rates, in part to generate additional domestic savings. The authorities had stated their intention of maintaining a flexible interest rate policy, and it would be useful to receive a further comment on their precise plans.

The greatest difficulties in recent months had obviously been experienced in the external sector, Mr. Taylor remarked. The current account deficit was sizable, and a large and rapid recovery in Zaïre's main export markets was not expected. Moreover, substantial debt repayments would fall due in 1982. The rather limited discussion in the staff reports of exchange rate policy was disappointing. It would be useful to hear clarification of the authorities' intention of maintaining a more flexible exchange rate policy than had been the case in the recent past.

The halt in 1981 in the progress in reducing external payments arrears was certainly worrying, Mr. Taylor said, but it seemed inappropriate to avoid a further accumulation of arrears by reducing imports by administrative means. Sustained progress in reducing arrears should be based on a somewhat more vigorous domestic adjustment effort together with an improvement in the performance of exports.

The cost of servicing Zaïre's external debt continued to be substantial, Mr. Taylor commented, and it could be difficult to cover in 1982 despite the considerable debt rescheduling that had occurred. It would be useful to receive the staff's view on the prospects for Zaïre being able to meet its 1982 debt service obligations in full and on schedule.

In the light of the medium-term need for stabilization, Mr. Taylor continued, an arrangement with Zaïre should give a high priority to maintaining realistic and flexible exchange rate and interest rate policies and a somewhat greater degree of fiscal restraint than in the recent past. In addition to monitoring the government deficit on a monthly basis, the authorities should improve their monitoring of domestic and external payments arrears. High priority should also be given to the ongoing effort to improve the administration of the major state mining and marketing companies.

He agreed with Mr. Nana-Sinkam and Mr. de Maulde, Mr. Taylor remarked, that the Fund's main objective with respect to Zaïre should be to ensure that the country was encouraged to continue to maintain economic policies that were essentially in the right direction. The solutions to the problems facing Zaïre's economy were fairly straightforward, and without them the prospects for the economy would be bleak.

Commenting on Zaïre's request to use the compensatory financing facility, Mr. Taylor said that he agreed with the staff that the weakness in world demand had been the main factor in the instability of earnings from cobalt and copper exports, but he agreed with previous speakers that the difficulties had been due in part to the authorities' cobalt marketing policy. Management deficiencies and infrastructural problems in the mining sector, particularly with respect to transportation and power supplies, had certainly contributed to the unsatisfactory export performance. Still, as the proposed purchase was moderate in relation both to quota and to the estimated overall export shortfall, it should be approved.

Executive Directors would certainly wish to give further thought to the important issues that Mr. Nana-Sinkam had raised in his opening statement, Mr. Taylor commented. The question of whether or not the authorities had met the test of past cooperation was a matter of judgment. The fact that the proposed purchase would not bring Zaïre's purchases under the compensatory financing facility above 50 per cent of quota seemed to imply that the staff felt that the authorities had not met the stricter test of cooperation; he tended to share the staff's view. An additional purchase by Zaïre under the compensatory financing facility when a new financial program was agreed with the authorities should be dealt with on the merits of the case if and when a request was made. As previous speakers had suggested, there were rather serious doubts about the admissibility of some elements of the total export shortfall calculated by the staff.

Mr. Prowse said that he basically agreed with the appraisal in the staff report for the 1981 Article IV consultation with Zaïre and with the comments on it by previous speakers. The lack of adequate control of public expenditure was a major problem, and the need to deal with it was urgent. As for the proposal to use the compensatory financing facility, it was fully consistent with existing policy and should be approved. Zaïre clearly had a balance of payments need to use Fund resources, and the export shortfall obviously exceeded the amount of the proposed purchase even when cobalt exports were excluded. He wondered whether the staff had any information on the price elasticity of demand for cobalt. He recognized that the concept of elasticity might not be applicable to the kind of market for cobalt that Zaïre faced. Nevertheless, the question of elasticity was important because the staff had taken the position that a lower price than Zaïre had actually charged would not have generated more export revenues through an increase in the volume of cobalt exports.

The present case of Zaïre, like some recent requests to use the compensatory financing facility, raised a number of important issues concerning the test of cooperation with the Fund, Mr. Prowse commented. The Executive Board had already decided to examine those issues on another occasion; for the moment, therefore, Zaïre's request should be considered in the light of the present understanding on the test of cooperation. In his opening statement, Mr. Nana-Sinkam had wisely suggested that "the Fund should distinguish between the successful

implementation of a program and the member's cooperation with the Fund." It was unfortunate that Mr. Nana-Sinkam felt that "the Fund is condemning a country that has tried, with Fund assistance, to adjust...." Mr. Nana-Sinkam had also said that "our concern is whether we are treating others, such as Zaïre, appropriately or on the basis of a flexible application of the principle of equal treatment to members." He himself had raised that issue in connection with cases concerning members of his constituency. The issue actually had two elements: uniformity of treatment at a particular time, and over time. Experience seemed to show that there had been uniformity in the application of Fund policies as between members, but the policies evolved over time, and further evolution of the test of cooperation in particular might be warranted. In any event, as Mr. Taylor had stressed, whether or not a member country had met the stricter requirement of cooperation was a matter of judgment. However, it was up to the Executive Board to make the judgment. The proposed purchase should be approved.

Mr. Polak said that the staff had struck the right note in its appraisal in the report for the 1981 Article IV consultation with Zaïre. As for the proposed purchase under the compensatory financing facility, the staff's considerable experience and expertise in calculating export shortfalls were reflected in the calculation of Zaïre's shortfall. Table 5 in EBS/82/27 clearly showed a large shortfall in the period concerned, even though cobalt exports were expected to rise from 6,000 tons in 1982 to 9,000 tons in 1983. The main issue, therefore, was whether the export shortfall had been caused by factors that were largely beyond the control of the authorities. Under present policy, a member country was not required to have taken every conceivable step in the past, and to do everything possible in the future, to optimize its income from a particular commodity export. Zaïre was not required by the terms of the decision on compensatory financing to discover the optimum marketing policy for dealing with the monopsonistic conditions in cobalt importing countries. There was no reason either to believe that any or all of the cobalt export shortfall had been due to actions by the authorities in Zaïre, or to exclude cobalt exports from the shortfall calculation. As for the cooperation issue that Mr. Nana-Sinkam had raised, Executive Directors already planned to deal with it in detail on another occasion in the near future.

The proposed purchase under the compensatory financing facility was to cover a shortfall in 1981, Mr. Polak noted, and the calculation of the shortfall was based on actual data for the first half of the year and on estimated data for the second half. The question of the use of estimated data had occupied the Executive Board to a considerable extent in recent months and had been brought to mind most recently by two new cases involving countries that had not met the expectation of prompt repurchase. Zaïre's free reserves had nearly run out. He wondered whether, if the present purchase request had covered the latest shortfall year in which actual data were available for all 12 months--June 1980--June 1981--there would have been a shortfall and, if so, how large it would have been. How much confidence did the staff have in the export

shortfall that was based on estimated data? What was the likelihood that the actual outcome might in fact be quite different from the staff estimates?

Mr. Kharmawan commented that an assessment of Zaïre's performance under previous stand-by arrangements suggested that its relationship with the Fund had been somewhat uneven; in some periods, all the performance criteria had been met, but in others the performance had been less satisfactory. Mr. Nana-Sinkam obviously felt that the nonobservance of performance criteria could be attributed primarily to external factors, while the staff had mentioned that there had been recurrent slippages in policy implementation and had referred to the existence of deep-rooted weaknesses in most of the productive sectors, large price distortions in the economy, and a legacy of a sizable external debt, most of which would fall due in the medium term. There had apparently been persistent overruns in expenditures on education, defense, and the presidency, but the staff reports clearly showed that economic policy had been moving in the right direction, and that certain improvements had been made. Indeed, the present economic situation was clearly much better than the one in, say, 1975 or 1976, and the authorities were obviously determined to make further improvements. In that connection, the cooperation between Zaïre and the Fund had been fruitful; Zaïre's economy obviously had not fallen back to the undesirable conditions of the mid-1970s. The authorities seemed to have recognized the weaknesses in their performance and were determined to do better over time. They had not met all the performance criteria under previous financial programs but, given the progress that they had managed to make, they certainly deserved the Fund's continued support.

The recession in the world economy had obviously had an adverse effect on Zaïre's commodity exports, Mr. Kharmawan said. The authorities' policies could conceivably have been somewhat more effective than had actually been the case, but the main cause of the problems facing the economy had clearly been external in nature. The postshortfall projections were naturally difficult to make, but they could be reviewed in coming months, and the purchase request should be accepted at the present meeting. The requirements of the stricter test of cooperation with the Fund had never been clearly defined to his satisfaction and, in any event, Zaïre's export shortfall was expected to be corrected in the two postshortfall years. Access to the compensatory financing facility was meant to deal with an imbalance attributable to specific external factors; accordingly, it seemed unfair to require a government to improve the overall balance of payments situation, which might have deteriorated as a result of a number of different factors. Compensatory financing had been designed to help countries deal with external imbalances caused by factors largely beyond the control of the authorities, and it was inappropriate to require a country using the facility to meet conditions that were normally attached to drawings in the upper credit tranches. The authorities in Zaïre had certainly met the test of cooperation for the proposed purchase under the compensatory financing facility. That the

authorities' policies were obviously moving in the right direction was sufficient evidence of their cooperation with the Fund. He looked forward to examining the general issue of cooperation further on another occasion.

Mr. Vidvei stated that the proposed decisions were acceptable. Some progress had been made in recent years toward achieving economic and financial adjustment, but the effort had not been sufficiently vigorous and sustained, and Zaïre continued to face serious difficulties. Indeed, recent information suggested that there had been a further weakening in the overall economic situation, because of major shortfalls in export earnings and capital inflows, slippages in policy implementation, and a resistance to introduce reform measures in a number of crucial areas. The authorities' intention of improving the operations of GECAMINES and SOZACOM and their plans for enhancing budgetary control and avoiding any proliferation of public sector institutions were certainly welcome, but the actual developments in the fiscal area had been worrying. The staff had concluded that there had been slippages in budgetary expenditure, notably in the areas of the presidency, political institutions, education, and subsidies; it had estimated that, through the third quarter of 1981, outlays on the presidency and political institutions had been double the target figure. The failure of the presidency and the political institutions to accept the needed degree of austerity had contributed to the nonobservance of the performance criteria. The staff had also noted that the authorities had made disbursements of some Z 190 million more than had been anticipated in the area of primary and secondary education, as they had found it difficult to implement the new system that had been designed to contain teacher salary payments. It had become clear during the previous Article IV consultation that one of the main problems in the expenditure field was excessive payments to teachers.

He fully agreed with the staff that strong revenue and expenditure measures would be needed in 1982, Mr. Vidvei remarked, and he was pleased that recent Fund technical assistance missions had found that there was room for making a number of changes in the tax structure and tax administration. Particular importance should be attached to strengthening the budgetary controls throughout the public sector. It seemed fair to doubt that the adjustment effort in Zaïre would succeed in the absence of acceptance by the presidency, political institutions, and religious groups dominating education of adequate restraint of their expenditure.

Mr. Jauregui remarked that apparently Executive Directors fully agreed that Zaïre's economy had generally improved somewhat in recent years. Zaïre had obviously made a number of important policy changes, including the adoption of a series of devaluations, the elimination of price controls on a wide range of commodities, and the introduction of new revenue measures--including an increase in certain excise taxes--and had made major efforts to change the interest rate structure. Policy-making was more difficult in developing countries than in advanced countries owing to widespread poverty and the maldistribution of income in the former, and Zaïre's nonobservance of performance criteria should be viewed against the overall adjustment effort of the past several

years. Since 1975 there had been important accomplishments in the area of government expenditure; in any event, a revision of an expenditure target should not be seen as evidence that the stricter test of cooperation under the compensatory financing facility had not been passed. Indeed, Zaïre had been working quite closely with the Fund and had amply met the stricter requirement of cooperation. Moreover, previous speakers had correctly stressed that the targets under the arrangements with Zaïre had probably been excessively strict, and that the Fund as well as the authorities should bear some of the responsibility.

He agreed with Mr. de Groote's position on the export shortfall of Zaïre, Mr. Jauregui continued. There was no certainty that, if Zaïre had substantially reduced the price of cobalt, buyers in the United States would have reacted by considerably increasing their purchases from Zaïre. Buyers of cobalt obviously took certain noneconomic factors into account in making their decisions. Over the years Zaïre had clearly cooperated with the Fund and had made an effort to implement appropriate adjustment policies. The proposed decisions should be approved.

Mr. Kiingi said that he accepted the purchase request. It met all the requirements for gaining access to the compensatory financing facility: the export shortfall had been caused by factors largely beyond the control of the authorities, the shortfall was temporary in nature, and there was a clear balance of payments need. There was no reason to doubt that Zaïre had been amply cooperating with the Fund. He looked forward to the scheduled discussion in the Executive Board on the Fund's approach to the requirement of cooperation.

The performance of the economy in the past year had been mixed, Mr. Kiingi remarked. GDP had continued to grow, and the rate of inflation had remained substantially below the triple-digit level that had prevailed just two years earlier, but the unexpectedly large decline in the terms of trade and the sizable debt service burden had caused a further deterioration in the balance of payments position. The authorities had had difficulty in meeting their external debt service payments obligations on schedule, and there had been some accumulation of arrears in the final months of 1981. The authorities had been unable to meet the target for the rate of growth projected under the medium-term plan, and low capacity utilization rates in the manufacturing sector had resulted from shortages of spare parts, materials, and fuel which the country had been unable to import because of the lack of foreign exchange.

Zaïre, like many developing countries, was particularly vulnerable to adverse movements in the export prices of a small number of commodities, Mr. Kiingi commented. Medium- and long-term planning was especially difficult in such circumstances, but much would depend upon the extent to which the authorities could succeed in their efforts to diversify the productive base. There was an urgent need for them to implement vigorously policies that could improve the allocation of resources to the productive areas while providing appropriate incentives to producers. Particularly close attention should be paid to agriculture; the output of staples had

either stagnated or declined in recent years, and the production of cotton, coffee, and palm fruit had continued to lag behind the sector's full potential. He was pleased that the authorities, with the assistance of the World Bank, were in the process of completing a comprehensive plan for the development of the agricultural sector.

Revenue and expenditure control measures had led to a considerable improvement in the financial position of the public sector, Mr. Kiingi remarked, but the revenue target for 1981 had not been met, partly because of shortfalls in customs receipts for both exports and imports; there had also been slippages in expenditure. As a result, the overall deficit in 1981 had been larger than had been expected, and net borrowing by the Government from the banking system had exceeded the ceiling by a wide margin. The authorities were aware of the problems and had begun to act to curb the budget deficit through both revenue and expenditure control measures. Such action was certainly needed if excessive growth in domestic demand and an intensification of inflationary pressures were to be avoided.

Zaïre was obviously one of the harder cases that the Fund had to deal with, Mr. Kiingi commented, but the Fund should avoid limiting its usefulness by appearing to be pessimistic about likely economic developments in the country. The Fund should pay closest attention to the basic trends and the overall attempt by the authorities to deal with what was clearly a very difficult situation. Although there had been occasional slippages, the authorities were obviously anxious to solve the problems facing the economy.

Mr. Jayawardena said that he fully agreed with the staff's view on the shortfall of cobalt exports. Moreover, Mr. de Groote had correctly noted that, given the monopsonistic market for cobalt, Zaïre's pricing policy had not been inappropriate. Indeed, as the staff had noted, Zaïre had resisted raising its prices in line with much higher prices in the free market in the first quarter of 1979; it was reasonable to conclude that, while its aim had been to maximize earnings, Zaïre had been conscious of the adverse effects of high prices on the long-term demand for cobalt. There was no evidence that Zaïre had in effect priced itself out of the market for cobalt.

In his opening statement, Mr. Nana-Sinkam had raised a number of fundamental issues that the Executive Board would have an opportunity to explore at length on another occasion, Mr. Jayawardena remarked. The judgment whether or not a member country had met the stricter test of cooperation had to be made by the Executive Board, rather than by management and the staff, and it should be based on the quality and the direction of the adjustment efforts that a member country had been making rather than solely on the performance with respect to established ceilings; in that connection, Mr. de Groote had usefully stressed that the ceilings under the arrangements with Zaïre had been quite strict. The proposed decisions should be approved, and when the negotiations with the authorities were resumed in April 1982, it would be appropriate for the Executive Board

to consider the possibility of granting Zaïre access to the equivalent of another 50 per cent of quota under the compensatory financing facility.

Mr. Zhang said that he agreed with the points that Mr. Nana-Sinkam had made in his opening statement and he accepted the proposed decisions.

The staff representative from the African Department remarked that in its report for the 1981 Article IV consultation with Zaïre the staff had attempted to strike the right balance in its description of the various factors that had contributed to the problems facing the authorities. Zaïre had clearly made satisfactory progress in 1980 and, on the strength of that performance, management and the staff had had a reasonable degree of assurance that the program for 1981 that had been presented for the consideration of the Executive Board was appropriate. A number of adverse developments had subsequently occurred, and the expectations of the authorities and the staff had not been borne out in fact. For example, fresh inflows of capital of SDR 100 million had been anticipated under three loan arrangements that the authorities had been in the process of negotiating at the time of the approval of the financial program for 1981; one of the arrangements alone--with a consortium of private banks--would have accounted for about SDR 100 million, but the negotiations on it had unfortunately been abandoned. The other two loans had been delayed; one, from the French Caisse Centrale de Coopération Economique, had been finalized, but had not yet been disbursed, while the other, from the European Communities, was still under consideration. The experience with the loans to Zaïre thus showed the difficulties the staff often faced in projecting capital flows in many member countries.

In negotiating the financial program for 1981 the staff had borne in mind the circumstances that were emerging in Zaïre, the staff representative went on. Accordingly, the ceiling on net credit to the Government in 1981 had been set at Z 850 million, whereas the actual figure had been Z 267 million in 1980. The staff recognized that the sharp improvement in 1980 was likely to prove to be temporary; hence, the program for 1981 included an increase in the overall government deficit from the equivalent of almost 1 per cent of GDP in 1980 to 2.3 per cent in 1981. In addition, because of the adverse external developments and in view of the need to expand imports, the staff had agreed that it would be appropriate to have the external current account move from approximate balance in 1980 to a significant deficit in 1981. In retrospect, it was reasonable to conclude that more could have been done in certain policy areas, although the program for 1981 had certainly recognized the latest developments to a sufficient degree. Indeed, some staff members had felt that the program might be viewed as excessively expansionary, rather than restrictive. In effect, the departures from the 1981 program targets had been sizable. For instance, the overall government deficit in 1981 was now estimated to have reached 5.2 per cent of GDP; net government borrowing from the banking system had amounted to about Z 1.3 billion; and the overall external deficit had been much larger than had been anticipated.

It was difficult to know the precise role played by the various exogenous and endogenous causal factors behind the larger budgetary deficit, the staff representative said. Preliminary data suggested that the revenue shortfall in 1981 had been of the order of Z 320 million, of which some Z 200 million was traceable to developments with respect to exports and imports which had been beyond the control of the authorities. On the other hand, budgetary expenditures, excluding external debt service payments, had reached approximately Z 5.1 billion, compared with the program target of Z 4.4 billion; the estimated Z 700 million in expenditure overruns was attributable largely to decisions made by the authorities. The overruns had included about Z 90 million for defense, Z 190 million for education, and Z 250 million for the presidency and political institutions. The expenditure overrun on the latter category had been roughly equivalent to the target for total expenditure on the presidency and political institutions. As a result, there had been substantial divergences from the credit targets. Net credit to the Government had exceeded the target by 50 per cent, and net domestic assets of the banking system by some 40 per cent, although those figures did suggest that the monetary authorities had made an effort to observe the ceiling on credit to the private sector.

In the light of the actual external developments in 1981 and the substantial departures from the targets under the financial program for 1981, the objectives that had originally been established for 1982 and 1983 no longer seemed attainable, the staff representative remarked. It was useful to note in that regard that, if the expenditure overruns had not occurred, the 1981 credit ceilings could have been observed despite the shortfall in revenue. That fact explained why the staff was particularly concerned about developments on the expenditure side. The quarterly expenditure ceilings had clearly not been observed, and the suggestion by one Executive Director for introducing monthly expenditure ceilings would certainly be explored by the staff in its future discussions with the authorities.

Commenting on public enterprises in Zaïre, the staff representative stated that in January 1982 the authorities had taken some steps to restructure the Boards of GECAMINES and SOZACOM. A World Bank mission had recently visited Zaïre to discuss the authorities' intentions with respect to GECAMINES and SOZACOM and had suggested possible ways of strengthening their organization and management. The authorities had promised to study the suggestions and to make their views known to the World Bank as soon as possible. The Government had decided to return certain public enterprises--mainly in the areas of agroindustry and manufacturing--to the private sector. It was the staff's understanding that other public enterprises, including some that were involved in transportation, had been given greater autonomy in decision making in general, and in setting prices in particular. Adjustments in administered prices had been made, but there had usually been significant delays during which the liquidity position of the enterprises concerned had become difficult.

Three comprehensive reports by a Fund technical assistance mission were being finalized, the staff representative said. They dealt with the fiscal regime of GECAMINES, other aspects of the tax system, and expenditure controls. The recommendations contained in those reports were along the lines of those described in the staff report under consideration at the present meeting. The recommendations by the technical assistance mission were to be submitted to the authorities for their consideration in the near future.

The balance of payments category of "private capital and errors and omissions" included a large element of errors and omissions, the staff representative explained. Thus, there was need for caution in interpreting the movement shown under that category in 1981 relative to 1980.

He agreed with Mr. de Maulde, the staff representative said, that the expected changes in the tax system were unlikely to have a significant immediate impact on the budget and, accordingly, the major emphasis in the fiscal field should be on the expenditure side. As for the behavior of the category of "other net domestic assets of the banking system," it had been a source of some difficulty in the past. In designing financial programs for Zaïre the staff had consistently wished to take into account credit developments in the economy in as comprehensive a way as possible, especially as the staff felt that, in Zaïre, "other assets" usually took the form of credit. The category of "other net domestic assets of the banking system" had increased sharply in 1981, particularly in the second quarter, for three reasons. First, there had been some degree of remonetization involving a reversal of the currency reform of late 1979 and, in effect, the creation of new money by the Bank of Zaïre, something that had not been envisaged under the financial program of 1981. Second, there had been a reduction in the import deposits required by banks of their customers. Third, there had been a sharp increase in miscellaneous expenditures by certain commercial banks.

The staff did not have firm figures on the volume of domestic arrears, the staff representative commented, but the pattern of government expenditure provided some evidence as to the likely figure. For instance, at the end of every quarter there had been a substantial slowdown in expenditure, which suggested that certain payments had been delayed.

The authorities were committed in principle to maintaining flexible interest rate and exchange rate policies, the staff representative said, but one of the difficulties had been that no further action in those areas had been taken since June 1981. A large number of interest rates in Zaïre were still substantially negative in real terms, and the staff agreed that nominal interest rates in the country should be increased further. Flexibility in exchange rate policy would involve frequent, small adjustments in the exchange rate.

It had obviously been difficult to contain imports in recent years, the staff representative remarked, and it would undoubtedly continue to be so in the coming period. Nevertheless, given the prospects for

exports, there would undoubtedly have to be an even stronger adjustment effort by the authorities than hitherto, including induced cuts in real imports, unless there was substantial assistance in the form of further debt rescheduling and other balance of payments aid from Zaïre's principal partners. The staff was concerned that, given the present external environment, there might well be a further accumulation of arrears on external debt service payments in 1982.

Commenting on the requirement of cooperation under the compensatory financing facility, the staff representative said that a number of the general issues that had been raised at the present meeting were reviewed in EBS/81/251. That paper was scheduled to be discussed by the Executive Board on April 2, 1982 and it seemed appropriate to concentrate his remarks on cooperation at the present meeting on the case of Zaïre. It had not been easy for the staff to prepare either the report for the 1981 Article IV consultation with Zaïre or the report on the country's request to use the compensatory financing facility. There had been some difficulty in collecting the necessary data and in establishing the degree of cooperation by the authorities. After careful consideration, the staff had reached the following conclusions: the shortfall in Zaïre's export earnings in 1981, based in part on estimated data, was of a short-term character and was largely attributable to circumstances beyond the control of the country; there was sufficient reason to believe that Zaïre would cooperate with the Fund in an effort to find appropriate solutions to its balance of payments difficulties; and, despite the contacts with the authorities in 1981, the staff felt that a convincing case could not be made at present that Zaïre had been cooperating with the Fund in an effort to find appropriate solutions to its balance of payments difficulties. The latter conclusion had been based on a number of factors. Policies agreed with the Fund had not been adequately implemented--particularly on the budgetary side--the departures from the established targets under the program for 1981 had been substantial, and hence the initial objectives for 1982-83 were no longer attainable. Zaïre's recent and present policies did not seem appropriate for dealing with its heightened internal and external financial difficulties. Furthermore, specific arrangements for an early mission to undertake new negotiations on the use of Fund resources had not been made with the authorities, so that there was some uncertainty whether new understandings in response to prevailing conditions would be reached.

In assessing Zaïre's degree of cooperation with the Fund the staff had not attempted to break any new ground, the staff representative from the African Department went on. Rather, it had meant merely to implement what it understood to be the existing policy on cooperation. While the staff fully appreciated the extreme difficulty of the situation in Zaïre, it could not support at the present stage a request by Zaïre that would bring its outstanding purchases under the compensatory financing facility above 50 per cent of quota. However, the staff would be prepared to examine such a request when it was satisfied that the stricter requirement of cooperation under the compensatory financing facility had been met on the basis of data that were available at the time of the request.

A Deputy Director of the Exchange and Trade Relations Department remarked that the comparison of Zaïre's performance with that of other member countries with multiyear Fund-supported programs was an important element in the staff's assessment. As a proportion of GDP, the deviation between the target for the budget deficit and the actual deficit had been greater in Zaïre than in most other member countries with operative extended arrangements. Similarly, the deviation of the actual current account position from the target was large in the case of Zaïre in comparison with other member countries; indeed, it was the second largest such deviation and, in the case of the largest one, negotiations on a new financial program were well advanced.

It was of course useful for policy and analytical purposes for one to attempt to attribute nonobservance of performance criteria to various exogenous and domestic factors, the Deputy Director said. However, in an important sense, the precise nature and cause of larger than expected external disequilibria were not fully relevant. Extended arrangements were designed to achieve a specific degree of adjustment over a three-year period. If for whatever reason the adjustment did not occur, the basic architecture of the original program was undermined. One of the main issues at hand was whether there was a reasonable prospect of bringing the adjustment effort in Zaïre back on track. To do so would involve a reduction in the overall government deficit from the equivalent of 5.2 per cent of GDP in 1981 to about 1 per cent in 1982 and a reduction in the deficit of the current account of the balance of payments from the equivalent of nearly 9 per cent of GDP to less than 6 per cent, and the overall balance of payments deficit, which had reached SDR 570 million in 1981, would have to be cut approximately in half in 1982. Such changes were large, and the staff wished to evolve policy options that would move the economy along the path of adjustment. The staff's balance of payments estimates were somber; the overall balance of payments was already in substantial deficit and was likely to remain so in 1983 and 1984--perhaps with some gradual improvement--in the absence of very strong actions by the authorities. Executive Directors' comments at the present meeting on some of the policy options in the areas of interest rate, fiscal, and exchange rate policy and with respect to the trade and payments system would be very helpful to the staff in its future work on Zaïre.

The staff representative from the Research Department said that actual data were now available through June 1981: the export shortfall for the 12 months to June 1981 had been approximately SDR 90 million, or less than half the shortfall estimated for the 12 months to December 1981. The authorities wished to use the data covering calendar year 1981 because exports in the second half of the year were estimated to have been lower than in the first half; export earnings for the period July-December 1981 had been estimated at SDR 560 million, compared with earnings of SDR 714 million for the preceding 6 months. A shortfall equivalent to at least the amount of the proposed purchase would be calculated so long as earnings in the period July-December 1981 did not turn out to be more than SDR 130 million higher than the estimated figure

of SDR 560 million. Hence, there was rather a wide margin of latitude in the case of Zaïre--about 23 per cent--compared with some other cases that had been dealt with under the procedure for early drawings.

The market price for copper in 1981 had been \$0.79 per pound, the staff representative explained, while Zaïre's export unit value had been just \$0.73 per pound. A market price averaging \$0.90 per pound and unit values averaging \$0.83 per pound had been projected for 1982. The figures represented a 14 per cent price increase in terms of U.S. dollars and a 16 per cent increase in terms of SDRs. The market price for copper in the opening two months of 1982 had averaged less than \$0.75 per pound and could remain depressed for several more months. Hence, if the projection for 1982 of \$0.90 was to prove to be accurate, the price would have to recover sharply--to more than \$1.00 per pound--in the second half of 1982.

The projections for 1982 had been based on the assumption that a recovery in world demand would begin soon after the middle of 1982, the staff representative remarked. If the pickup in demand was delayed, the projected recovery in the price of copper for Zaïre would not be fully accurate. However, the staff felt that, when the pickup did occur, conditions in the world copper markets suggested that subsequent price increases would be sharp and quick. For instance, stocks of copper in both producing and consuming countries were at a historically low level, as high interest rates had discouraged stock holding, and production capacity had been scaled down in many countries, particularly major producing countries in North America. There were moreover some uncertainties about the supplies from certain large producing countries, such as Poland; and the negotiations of labor contracts in Canada--in the middle of 1982--and in the United States--in mid-1983--could lead to precautionary stock building. The staff had projected a price for copper of \$1.15 per pound in 1983 and an average unit value of \$0.97 per pound; those figures might well prove to be on the low side. Indeed, on average, the projected unit values of \$0.83 in 1982 and \$0.97 in 1983 were probably conservative.

The staff paper dealing with the meaning of shortfalls that were largely beyond the control of the member country was due to be discussed by the Executive Board in the near future, the staff representative continued, but it might be useful to make some general observations at the present meeting. Under the decision on the compensatory financing of export fluctuations, the shortfall in total export earnings had to be attributable largely to circumstances beyond the control of the member country. The practice had been to consider the total shortfall as compensable once a judgment based on all the relevant factors could be made that the total shortfall was attributable largely to factors beyond the control of the member. On page 8 of EBS/82/27 the staff had concluded that the sum of the shortfalls for copper, coffee, diamonds, and a group of miscellaneous exports--aggregating about SDR 128 million, or 60 per cent of the shortfall estimated for all exports--was attributable to factors that were clearly beyond the control of the authorities in Zaïre.

The staff also felt that the shortfall in cobalt exports had also been due to factors largely beyond the control of the authorities, the staff representative commented. The staff believed that the sharp increase in the price of cobalt in 1979-80 and the subsequent decline had been caused by shifts in world demand. It was true that prices in the shortfall year--1981--had been affected by adverse developments with respect to demand, but it was also true that the rise in prices in 1979-80 had been triggered by a surge in world demand following events in mid-1978. In response to the strong demand conditions since early 1978, Zaïre, like other exporters, had attempted to increase its export earnings, an effort that was certainly not unreasonable for any country to make. It would be unreasonable to expect member countries not to attempt to increase their exports when demand conditions so permitted simply in order to achieve stability in their export earnings, thereby avoiding an export shortfall.

The staff recognized that substitution of other minerals for cobalt had occurred in 1981, the staff representative continued, but substitution often took place in periods of high prices. The rise in prices in 1979-80 had been due primarily to the surge in world demand, and Zaïre should not be held responsible for the subsequent increase in substitution. The volume of Zaïre's cobalt exports had declined in both 1979 and 1980, but it was far from certain that, even if Zaïre had lowered its price and increased its volume of cobalt exports in both of those years, the cobalt export shortfall would have been smaller than had actually been the case. Lower prices in 1979-80 would have slowed the pace of substitution in the shortfall year, but by 1981 consumer inventories would have been built up to even higher levels than had actually occurred, and the demand for Zaïre's cobalt exports in that year would have been even more depressed than it had in fact been, with the result that Zaïre's earnings from those exports would have been even lower than had actually been recorded.

It was true, the staff representative said, that Zaïre's share of the U.S. market for cobalt had declined in 1981, but it had also shrunk in 1979 and 1980. Hence, the decline in market shares had affected the trend in earnings. Zaïre's share of the U.S. market might have grown somewhat if it had lowered its price for cobalt exports, but the staff had concluded that the earnings of cobalt exporting countries, including Zaïre, would in that event have been much lower. There were obviously many difficulties in quantifying the effects of a marketing policy like Zaïre's on the stability of the country's export earnings over a trend period as long as five years, but after careful research the staff was satisfied that Zaïre had been following market conditions, rather than leading them, in the period 1979-81. Zaïre could conceivably have dropped its cobalt price in 1981 by a greater extent and more quickly than it actually had, but it was also true that the increase in Zaïre's prices in 1979-80 had lagged behind the rise in the spot market price.

In assessing Zaïre's cobalt pricing policy, the staff representative continued, Executive Directors should bear in mind that there was a difference between the officially quoted selling price and the price at which cobalt was actually sold, as Zaïre had had to offer substantial discounts. For instance, in 1981 Zaïre had sold a large volume of cobalt to the United States at a price of \$15 per pound compared with the quoted price at the time of about \$20 per pound. A similar pattern had prevailed in earlier periods.

In calculating the shortfall in cobalt exports, the staff representative explained, the staff had to make a realistic assumption about the price for the commodity in the two postshortfall years. Having held extensive discussions with experts, the staff had concluded that a figure of \$10 per pound represented a reasonable estimate of the average price for the coming two years. Excluding cobalt export earnings from total exports in the calculation of the compensable shortfall did not seem to be a reasonable solution. Indeed, the practice of excluding selected commodities from the calculation of the total export shortfall could sometimes give member countries a larger compensable shortfall than would otherwise be the case.

It was difficult to estimate the price elasticity of demand for cobalt, the staff representative remarked, and no estimates suitable for use in the current case were available. The opinion was widespread, however, that in the short run, the demand for cobalt was price inelastic.

Responding to a further question, the staff representative from the Research Department said that it was difficult to attribute with precision the reduction in Zaïre's share of the U.S. cobalt market to any particular factor. There was some evidence that Zambia had been exporting cobalt at a higher price than Zaïre and had nevertheless recorded an increase in its share of the U.S. market.

Mr. El-Khoury noted that in the past some Fund-supported financial programs had included a ceiling on net domestic assets and others had included a ceiling on net domestic credit. On a previous occasion, when a Fund-supported program was being discussed, he had asked the staff why they chose to place a ceiling on net domestic credit rather than on net domestic assets. Their answer at the time was that net domestic credit was more controllable by the authorities. He himself believed that that conclusion was applicable to all member countries. Was there some feeling that a ceiling on net domestic assets was preferable when it was suspected that some credit items might be classified as "other net domestic assets"?

The Deputy Director of the Exchange and Trade Relations Department replied that there was no standard approach; the treatment varied from country to country. The bank balance sheets of some countries were more detailed than the balance sheets of others. In some cases, credits had been unclassified or misclassified. In those cases, the staff felt that, as a safeguard for the Fund, particularly with respect to the performance criteria, it was useful to include an operative performance clause relating to net domestic assets.

Mr. Nana-Sinkam, commenting on the response by the Deputy Director of the Exchange and Trade Relations Department, said that he was rather surprised at the response because there was a team of five international experts working in the central bank of Zaïre, and the Fund staff ought to be able to trust their figures. As to the other staff replies to Executive Directors, he did not understand why the staff representative from the African Department had put so much emphasis on the internal sectors in Zaïre. It was true that in establishing a program for Zaïre the staff had had to take into account the existence of three loans, one from a Swiss consortium, one from the French Caisse Centrale de Coopération Economique, and one from the European Communities. In fact, little had been disbursed either by the Caisse Centrale or by the European Communities. His own information was that the Swiss loan had never materialized because of a difficulty between Zaïre and the World Bank in connection with GECAMINES. He only mentioned the point to complete the picture.

As to the relationship between Zaïre and the Fund, Mr. Nana-Sinkam observed that even the Zaïrian authorities agreed that they had not implemented the program; but the point he had made in his opening statement was that the failure to adhere to the program could not be attributed only to Zaïre. While the Zaïrian authorities had accepted the projections made by the staff, it was pertinent to ask whether they had been realistic in the first place. Zaïre could not be blamed for events that took place in the external sector, over which it had no control. As Zaïre was completely incapable of controlling the markets for cobalt or copper, there was no way in which the authorities could have controlled either the volume of exports or the amount of revenue derived from exports. It was for those reasons that he felt it improper to devote so much attention to the domestic side of the Zaïrian economy while only glancing at the external sector.

Dealing with the overall budget deficit, the staff representative from the African Department had tried to apportion it line by line, Mr. Nana-Sinkam noted. He had, however, not done the authorities entire justice, as increases on one line had been offset by reductions on another. What was important was to consider the way in which the data should be presented. It was true that there was a total deficit of Z 1.3 billion, but if the Z 550 million referred to by the staff was subtracted, the remainder would be no more than Z 725 million, of which Z 320 million was covered by revenues. If, in addition, an accumulation of arrears was subtracted from the expenditure side, the figures would not come out at all in the way presented by the staff representative. While he agreed that the Zaïrian authorities had to bring expenditure under control, merely balancing the domestic budget would not solve Zaïre's problems. All the difficulties in the external sector would remain. Zaïre could really do nothing to increase its exports--if the price of copper rose, importers stopped buying--and if there was no inflow of capital into Zaïre, there was nothing that the Zaïrians could do to obtain it abroad.

It was perhaps worth bearing in mind, Mr. Nana-Sinkam considered, that in the period 1980-81, Zaïre had obtained SDR 91 million net from the Fund and had repaid SDR 125 million to foreign banks. Perhaps the real reason why the Zaïrian authorities had not met the criteria in the external sector was precisely because they had done their best to meet their obligations and repaid more than they had received. The staff representative had suggested that the authorities ought to cut imports, and some speakers had suggested that the cuts should be achieved by administrative measures. In the present circumstances, given the sensitivity of Zaïre's exports in world markets, there was bound to be a reduction of imports without the need for any administrative measures. But it should be clearly understood that a reduction in imports brought with it a fall in government revenue. There was, however, another problem associated with a cut in imports: it would be difficult to ask the country to accept a smaller supply of goods and at the same time adopt exchange rate flexibility. The outcome was bound to be a sizable cut in investment and, consequently, a severe blow for the supply side of the economy which the Fund was trying to encourage.

Commenting on Zaïre's debt, Mr. Nana-Sinkam said that it was clear that the authorities would have to agree on a program with the Fund because the country's creditors would be unlikely to deal with Zaïre unless there was first a stabilization program. The situation was therefore rather difficult. On the question of compensatory financing, he agreed with the staff that the shortfall was outside the control of the authorities. It was unclear to him, however, why the staff felt that the Fund could not at present make available more than 50 per cent of quota under the compensatory financing facility. The budget deficit could hardly be a reason for such a restriction. He saw little connection between the budget deficit and the test of cooperation, and it seemed unreasonable to deny Zaïre greater access under the facility on that ground. The staff representative from the African Department had mentioned that he did not believe that it would be possible to agree on a program with the Zaïrian authorities, and that the staff had not in fact been approached by the authorities. However, on the basis of instructions received from his authorities, he had said in his opening remarks that they were expecting another mission in Zaïre some time in April 1980. The Governor of the central bank had said quite clearly that, after the Article IV consultation, he looked forward anxiously to resuming discussions with the Fund and to establishing a new program.

He was rather concerned by the observations of the Deputy Director of the Exchange and Trade Relations Department, which appeared to be based merely on comparisons, Mr. Nana-Sinkam stated. The Executive Board had recently discussed another country in his own constituency, which had undertaken to reduce the budget deficit from 15 per cent of GDP to 14 per cent. The Executive Board had taken the view that the country was performing very well and that the Fund should do its best to assist. The Deputy Director had however remarked that to put the program for Zaïre back on track it would be necessary to reduce the budget deficit from 5.2 per cent of GDP to about 1 per cent, and to reduce the external

current account deficit from 19 per cent, to approximately 6 per cent. The 5.2 per cent figure in the previous program had been by no means sacrosanct, and if it proved impossible to reduce it to 1 per cent, blame should not be attached onesidedly to Zaïre alone. The Fund should be more realistic in its approach to what countries could and could not do.

Discussing Zaïre's difficulties in exporting cobalt, Mr. Nana-Sinkam remarked that cobalt was used to sink aluminum, particularly in connection with the manufacture of weapons. If potential importers used less than Zaïre might hope, there was little that Zaïre could do about it. The purchasers were in a monopsonistic position; the main user of cobalt had a stockpile and did not wish to purchase any more. As cobalt was a by-product of copper, Zaïre could hardly control its production independently; all it could do was to stockpile the surplus. Even if Zaïre were to lower the price, he wondered whether the United States would in fact import a great deal more.

Responding to questions raised by Executive Directors, Mr. Nana-Sinkam recalled that Mr. Kohnert had said that he did not believe that the shortfall submitted by Zaïre as the basis for a request for a drawing under the compensatory financing facility was really outside the control of the member. His argument had been that the marketing strategy and the pricing system had been inappropriate. As shown on page 11 of EBS/82/27, even in 1979 the price of cobalt in Zaïre had been well below the spot market price; Zaïre's pricing policy was evidently not at fault. Moreover, there was virtually no elasticity at all in the price of cobalt, and a change in price would hardly affect the amount absorbed in the market. Moreover, if there were indications in the market that the supplier should be able to obtain more for its cobalt, he saw nothing wrong in raising the price. In 1979, when the price had been very high, Zaïre had not raised its price to the spot market level. There was no reason to believe that the staff projections were wrong; the World Bank had had very similar figures, and the staff had been even more conservative.

He was grateful to Mr. Joyce for suggesting the lines along which a Fund mission to Zaïre should be working to establish a new program, Mr. Nana-Sinkam stated. Mr. Joyce had, however, asked what type of guarantees could be offered by Zaïre in order to encourage donors. He did not believe that any guarantees would have the desired effect unless there was another program with the Fund.

As to Mr. Taylor's comments regarding the test of cooperation being a test of judgment, Mr. Nana-Sinkam remarked that he agreed entirely; unfortunately, using the staff's own reasoning, it was possible to reach entirely different conclusions, as he had done in his opening statement. He hoped that the Executive Board would make some judgment and offer the staff the guidelines along which to proceed. The judgment regarding the test of cooperation was too important to be left to the staff alone. As to Mr. Prowse's comment that it was important that all members of the Fund should be treated uniformly, he did not believe that there were any uniform guidelines. His own feeling was that the Fund applied a policy

that shifted from one country to another, even if they were in the same circumstances. He quite agreed with Mr. Prowse that it was highly desirable to have an agreed but flexible framework within which to apply the test of cooperation.

He also agreed with Mr. Vidvei, Mr. Nana-Sinkam went on, regarding the need to reduce expenditure under the heading of presidential dotations and on political institutions. However, it might be useful to give some idea of the position of education in Zaïre. In the first place, Zaïre was very large--as big as the whole of the European Community and Poland combined; consequently, it might be necessary to go from, say, Warsaw to Paris merely to apply to enter the Institute of Health Studies. The cost of implementing an educational program in Zaïre was bound to be very high. Moreover, he was by no means surprised that figures prepared in the capital should turn out to be unrealistic once efforts were made to apply the program elsewhere in the country. It was for such reasons that he had long encouraged Executive Directors to join the staff when it went on mission to different parts of the world. There was nothing to prevent Executive Directors traveling on mission; indeed, as he understood it, at one time field missions had been led by Executive Directors. If it was possible for Executive Directors to undertake more travel to the countries of their colleagues, they would have a better chance of understanding the situation as it actually was.

On the question of cooperation, Mr. Nana-Sinkam remarked that the Fund was quite unique in the sense that there was no comparable institution. For that reason alone, the Fund's policies ought to be flexible, because there was no way of comparing what the Fund was doing with what any other institution was doing. He took the opposite view of cooperation from that apparently taken by the staff. If a program was successful, it was a sign that cooperation existed; without cooperation between the Fund and the member country, the program would never succeed. It was really of no value to say that successful completion of a program showed a willingness to cooperate. He was not particularly attracted to the idea of introducing monthly ceilings, as suggested by one speaker. The international team in the Ministry of Finance in Zaïre ought to be able to provide very substantial assistance without the Fund introducing such minute control. The whole question of cooperation and the compensatory financing facility was to be discussed at length on April 2. Meanwhile, he sincerely hoped that, once a program had been arranged with Zaïre, the authorities would be able to draw the remaining 50 per cent available to them under the compensatory financing facility, naturally on the basis of a new paper by the staff.

Mr. Polak said that he was grateful to the staff representative from the Research Department for his reassurance. He had been worried that the present proposal for compensatory financing, based on estimated data for 6 of the 12 months, might lead to another case of overcompensation. As he understood it, Zaïre had "earned" the SDR 90 million shortfall and the other SDR 16 million was unlikely not to be "earned" in the second 6 months.

The Executive Board had discussed the question of overcompensation at EBM/82/1 (1/6/82), Mr. Polak recalled, and the Managing Director had terminated his summing up by saying: "Should experience in the future show...a deterioration in the repurchase behavior attaching to such cases of overcompensation, the Executive Board would review the whole policy issue." To his mind, the arrival of two such cases on the agenda of the Executive Board in one week did constitute deterioration in the experience with respect to overcompensation, one that had not been expected when the matter had been discussed in January. He therefore hoped that the topic could be put on the agenda, perhaps in connection with other aspects of the compensatory financing facility to be discussed on April 2.

The Deputy Managing Director remarked that one of the cases mentioned by Mr. Polak was being resolved; it seemed likely that the Executive Board would be officially notified in two to three days. Nevertheless, he would have no difficulty in reviewing the topic on April 2, 1982.

Mr. Taylor stated that he would assure Mr. Nana-Sinkam that he had not intended to imply that he saw scope for further reductions in imports through administrative measures. On the contrary, it seemed to him that the licensing arrangements in Zaïre meant that there was a rather close link between export receipts and authorization to purchase imports, which seemed to be a form of rather undesirable exchange rationing. He would like to see a continuation of the liberalization of import restrictions.

Taking up Mr. Nana-Sinkam's comment that he would like to see Executive Directors travel to countries other than their own, Mr. Taylor said that his wish was identical to that of Mr. Nana-Sinkam. Unfortunately most Executive Directors were closely tied to their desks in Washington. Nevertheless, on some occasions his office at least was able to draw on the expertise that existed in other departments of the U.K. Government, which did have resources that enabled them to send expert advisors to many developing countries. Consequently, many of the comments that were spoken by him did reflect expertise originating in quite personal contacts with the country concerned.

Mr. Nana-Sinkam replied that he agreed with Mr. Taylor that the authorities should continue to liberalize the import licensing system. On Mr. Taylor's second point, all the expertise in the world filtered through London could not replace personal visits on the spot.

The Chairman remarked that the discussion showed that the staff papers had provoked a great deal of constructive reaction by the Executive Board. He was glad that the Executive Board should work in that way; he saw it as a forum for understanding, discussion, and consultation leading toward better ideas for the good of the Fund as a whole. If the meeting had been rather long, it was because of the questions of principle that Mr. Nana-Sinkam had so usefully brought forward.

On the whole, the Chairman continued, he did not believe that the Fund had been too strict in setting performance criteria. It was certainly true that 1981 had been a more unsatisfactory year externally for Zaïre than had been hoped. But the Fund's essential task was to try to determine the deficit that the country could afford to finance; the fact that some of the unsatisfactory developments in Zaïre's economy were due to external factors did not make the financeable deficit any more sustainable. He would still maintain that, despite the harshness of the external world, Zaïre could not afford any larger deficits than those agreed with the Fund. It would be satisfactory if donors produced more aid in those circumstances; unfortunately, they did not. Consequently, when he had seen the program slipping, he had advised the Zaïrian authorities to do more than the Fund had advised, rather than less. On that point he had been perfectly consistent. For the past three and a half years he had been trying to enable the Fund to give more assistance to countries to make adjustment possible; but he saw no benefit in providing additional funds to try to offset external conditions that turned out to be worse than expected. To act in that way would require far more than 450 per cent of quota per country and would place in jeopardy the revolving character of the Fund's resources. Furthermore, the Fund did not have that volume of resources.

He was not impressed by arguments about the weight of external factors as against domestic factors, the Chairman observed; whatever the outcome, more adjustment was needed. He was of course not saying that, when a country had a multiyear program with the Fund, the Fund should insist on sticking to the original figures even when the situation changed. But, while the Fund had introduced a certain amount of flexibility into its operations, it would be entirely wrong to modify programs or abandon performance criteria because of changes in the outside world. The Fund examined the circumstances of each separate country individually, and then held staff meetings to ensure evenhanded treatment for all. It was most disappointing that it had not been possible to save the program with Zaïre. The Fund would certainly hold discussions with the authorities and try to arrive at a different program. However, when a multiyear program had slipped, the Fund would have to ask the country to show greater willingness to control its financial affairs.

Indeed, one of the most important considerations for the Fund in any forthcoming discussion, the Chairman considered, would be to gauge the earnestness of the authorities' intentions. What the Fund would have to ascertain was whether the authorities really wished to make adjustments in their fiscal outlays; and it would probably insist on preconditions, by which he meant undertakings to adopt measures that would convince staff, management, and the Executive Board that action would follow. Any discussions would also encompass the problems of the firms SOZACOM and GECAMINES, for which a solution was overdue. Management and staff would however be very careful not to return to the Executive Board with a program that was unworkable.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the views expressed in the staff appraisal on the 1981 Article IV consultation with Zaïre. They recalled that in recent years progress by Zaïre toward economic and financial adjustment had not been sufficiently vigorous or sustained, and the country continued to face serious difficulties. Under the medium-term program, in support of which the Fund had approved the extended arrangement, the Zaïrian authorities had taken important corrective measures in the first half of 1981 with some initial success. In particular, the large devaluation of the currency, the liberalization of the domestic pricing system, the improvement of the interest rate structure, and the reorientation of the foreign exchange allocation system in favor of priority sectors had helped move the economy in the right direction. However, progress was short-lived, as program implementation faltered in the second half of the year. Directors agreed with the staff's view that the 1981 program had run into difficulties, owing in part to a shortfall in export earnings and capital inflows, but also to weaknesses in policy implementation and the slowness of reform in a number of crucial sectors. Government expenditure overruns in several major areas were a source of particular concern.

Despite these policy weaknesses and the consequent failure to achieve the growth and balance of payments targets of the program, Directors noted that progress continued to be made in reducing inflation. They welcomed the intention of the Zaïrian authorities to take additional policy measures in certain areas to promote economic adjustment and recovery. In that regard, Directors underlined the importance of urgent action to improve budgetary controls, raise budgetary revenues, cut back public expenditure, particularly in the areas where overruns had occurred, avoid the proliferation of public sector institutions, strengthen the organization, accounts, and management of the mining sector (GECAMINES and SOZACOM), and liberalize further the pricing system.

The existence of negative real interest rates was noted, and the authorities were advised to correct this situation. A number of Directors also stressed the importance of providing to the private sector sufficient access to domestic credit. This makes the limitation of credit to the Government all the more crucial.

Directors urged the Zaïrian authorities to make maximum efforts to improve confidence in the economy, both internal and external, by discharging public debt service obligations, reducing commercial arrears in an orderly manner, curbing the disparity between the official and parallel market rates for the zaïre, pursuing a flexible exchange rate policy, and improving foreign exchange management. In this respect, a liberalization of the trade and payments system would also be essential.

Several Directors expressed the hope that there would be an early resumption of negotiations between Zaïre and the staff on the use of Fund resources in the upper credit tranches. They emphasized the need for the authorities to clearly demonstrate their resolve to alleviate the structural problems in the economy, as well as to promote internal financial equilibrium and a sustainable external payments position. The authorities would have to show their ability to control more effectively public sector expenditures. In view of the relatively unfavorable external environment, this would require even stronger adjustment policies and measures. It was also recognized that such efforts would have to be supported by external resources if they were to have a reasonable chance of success.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision relating to Zaïre's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1981 Article XIV consultation with Zaïre, in the light of the 1981 Article IV consultation with Zaïre conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Zaïre's exchange system involves restrictions on payments and transfers for current international transactions, including external payments arrears, and a new multiple currency practice, as described in SM/81/241. The Fund notes with satisfaction the abolition in February 1980 of a multiple currency practice, the significant reduction of external payments arrears through rescheduling and cash payments, and the authorities' intention to pursue a flexible exchange rate policy. The Fund urges the authorities to remove the remaining restrictions on payments and transfers for current international transactions as soon as possible. In the meantime, in the light of Zaïre's adoption of comprehensive policies for balance of payments adjustment, including policies to reduce progressively the amount of arrears outstanding and reliance on other exchange restrictions, which are supported by an extended arrangement from the Fund (EBS/82/126), the Fund grants approval for the retention of these restrictions and the new multiple currency practice until December 31, 1982, or the next Article IV consultation, whichever comes first. The Fund also urges Zaïre to examine the possibility of eliminating bilateral payments agreements with Fund members.

Decision No. 7071-(82/28), adopted
March 12, 1982

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/27 (3/10/82) and EBM/82/28 (3/12/82).

4. BANGLADESH - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/82/56 (3/5/82). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1981 Article IV consultation with Bangladesh until not later than March 22, 1982.

Decision No. 7072-(82/28), adopted
March 10, 1982

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/130 through 81/135 are approved. (EBD/82/51, 3/4/82)

Adopted March 10, 1982

6. EXECUTIVE BOARD TRAVEL

Travel by an Advisor to an Executive Director as set forth in EBAP/82/74 (3/10/82) is approved.

APPROVED: August 16, 1982

LEO VAN HOUTVEN
Secretary

