INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/19

10:00 a.m., February 19, 1992

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	A. Raza, Temporary
	Wei B.
	D. Powell, Temporary
T. C. Dawson	Q. M. Krosby
	V. Kural, Temporary
E. A. Evans	R. L. Knight
R. Filosa	J. Papadakis
	B. Bossone, Temporary
	A. F. Mohammed
I. Fridriksson	J. A. Solheim
H. Fukui	N. Tabata
	M. Nakagawa, Temporary
B. Goos	B. Esdar
	T. Sirivedhin
A. Kafka	J. C. Jaramillo
	I. Martel
	O. Kabbaj
	L. J. Mwananshiku
D. Peretz	P. Wright
	Z. Trbojevic
	Y.-M. T. Koissy
	R. Marino
	M. Da Costa, Temporary
	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

IBRD: J. E. Todd, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; J. A. Clément, K. B. Dillon, J. P. Gordon, M. Nowak. Exchange and Trade Relations Department: J. T. Boorman, Director; T. Leddy, Deputy Director; S. C. Brown, G. R. Kincaid. External Relations Department: S. J. Anjaria, Director. Fiscal Affairs Department: J. R. Modi. Legal Department: H. Elizalde. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. Jbili, A. Leipold. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; W. Y. Byrne, J. C. Corr, Z. Farhadian-Lorie, D. Gupta, P. R. Menon. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Fajgenbaum. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, L. E. Breuer, C. D. Cuong, B. R. Fuleihan, M. Galán, J. M. Jones, B. Szombati, A. M. Tanase, N. Toé, S. von Stenglin. Assistants to Executive Directors: B. Abdullah, G. Bindley-Taylor, J. H. Brits, Chen M., S. B. Creane, Deng H., H. Dognin, Duan J., S. K. Fayyad, O. A. Himani, J. Jamnik, R. Meron, F. Moss, J. A. K. Munthali, J. K. Orleans-Lindsay, E. H. Pedersen, S. Rouai, F. A. Sorokos, R. Thorne, C. M. Towe, J. W. van der Kaaij.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Papadakis as Alternate Executive Director for Greece, Italy, Malta, Poland, and Portugal.

2. REPORT BY MANAGING DIRECTOR

The Managing Director remarked that the previous week he had participated in UNCTAD VIII, held in Colombia, where he had focused his remarks on broad issues with important implications for the prospects of developing countries. The main topic for consideration at UNCTAD VIII was not one on which the Fund had to express particular views, namely, what should be UNCTAD'S mandate in a changed global environment.

While in Colombia, he had met with President Gaviria, the financial authorities, and leaders of Congress, as well as representatives of the entrepreneurial and labor sectors--all in an extremely pleasant atmosphere, the Managing Director continued. The country was moving in the right direction with remarkable perseverance. The authorities had recently accelerated their structural adjustment effort aimed at further opening the economy and introducing greater flexibility in the financial sector while maintaining prudent financial policies. Their current concern was how to respond to a surplus in the budget and, in particular, to the upward pressure in the exchange market owing to the reflow of capital into the country.

The Colombian authorities highly appreciated the long tradition of dialogue with the Fund as well as the kind of surveillance that had been established in their economy, the Managing Director observed. He had been impressed by the entrepreneurial sector's support for the authorities' efforts to open and restructure the economy. Such support tended to be greater in the industrial sector than in the agricultural sector, where there was still resistance to the authorities' strategy for opening up the economy.

He had taken the opportunity of his visit to the region to accept the invitation of the President of Peru to visit his country and to express publicly the views of the Fund, the Managing Director commented. To that end, he had utilized all possible channels, including television, radio, and contact with a great variety of people--the President, members of the Senate, the entrepreneurial sector, trade unions, and the Archbishop of Lima--and had emphasized two points. The first was the need for Peru to avail itself of a modern tax system commensurate with its goals of establishing social safety nets, the necessary means for fighting drug trafficking and terrorism in the country, and basic public infrastructure. The second point, which he had repeated in all forums and on all occasions, was the need to raise the tax/GDP ratio from its current level of 8 percent, the average ratio of developing countries being around 18 percent. The authorities understood that point, as well as the Fund's emphasis on the privatization and commercialization of public enterprises. Although the authorities had moved slowly in that area, at present the President as well as certain members of Congress were convinced of the need for progress in that regard. Finally, he had also stressed the virtues of dialogue with the Fund.

The situation in Peru continued to be extremely difficult in view of the ongoing fight against terrorism and drug trafficking, the Managing Director stated. Despite the difficult security environment, the country was continuing with its adjustment effort, and he admired the courage of those government leaders and entrepreneurs who were looking to the future and were undaunted by the obvious risks. In sum, there had been an unambiguous display of commitment to Peru's adjustment program and a recognition by all concerned that there was no alternative to the current course.

The Executive Directors took note of the Managing Director's remarks.

3. UNAUTHORIZED DISCLOSURE OF INFORMATION

Mr. Fukui stated that he wished to raise a matter of considerable concern to his chair. He had recently sent a memorandum to members of the Board and certain staff members regarding a recent article in O Estado de Sao Paulo on the Board's discussion of Brazil's request for a stand-by arrangement (EBM/92/9 and EBM/92/10, 1/29/92). He would not repeat the content of that memorandum; rather, he wished to express his regret that details of the discussion had been disclosed to the public. He was very much annoyed to see that the newspaper had quoted "one person present at the discussion." If that was the case, he was seriously concerned that the Board's tradition of a free and objective exchange of views was threatened because of the irresponsible attitude of one person.

He was particularly concerned about one aspect of that breach of confidentiality, namely, that the disclosure of a division of views in the Board could undermine the consensus that had been reached in support of Brazil's program, Mr. Fukui continued. In fact, the previous day an economic mission from Japan composed of prominent representatives from the financial and economic fields, including most of the leading commercial banks in Japan, had visited Washington to get an update on developments and to assess the economic prospects of some Latin American countries which it intended to visit. Unfortunately, articles such as the one he had cited could send a counterproductive message regarding the Brazilian economy to the very international financial institutions with which Brazil was trying to normalize relations.

He knew from personal experience that it was difficult to control the press, which meant that all concerned should be even more careful in their dealings with the media, Mr. Fukui commented. Once the Fund started to show a lax attitude toward maintaining strict confidentiality, there would be no end to such news accounts. In that sense, the Fund's policy on dealing with the press needed to be maintained through constant effort and attention. In the circumstances, he would very much appreciate management's comments on the issues he had raised as well as assurances on the part of Directors, management, and the staff that commitment to confidentiality remained a firm policy of the Fund.

The Chairman stated that he welcomed Mr. Fukui's remarks and entirely shared his concerns regarding the recent unfortunate development and its implications for the Fund's decision-making process. Mr. Fukui's views, which were certainly shared by all around the table and among the staff, had been echoed in memoranda circulated by Mr. Al-Jasser, Mr. Kafka, and Mr. Peretz to their colleagues. He had read the article to which Mr. Fukui had referred, and it was difficult to escape the conclusion that the information given to the journalist must have come direct from someone who was present at the discussion in the Board Room. The description of the meeting was so precise and so detailed, even if perversely biased, that the violation of the Fund's confidentiality must be considered as no mistake: it had been deliberate. It was a most serious affair, and the most grievous breach of confidentiality in his experience in the Fund. There had been other leaks, and he had reacted strongly to them, but they had been leaks of documents. In the current instance, the thrust of the Board discussion itself had been leaked. That was intolerable, because it was of critical importance that the Board's discussions continue to be frank and open. The Board and management must remain vigilant against any unauthorized disclosure.

He realized that it was difficult to defend against someone who would deliberately violate the mutual trust that was necessary if the Fund was to continue to act responsibly in areas of concern and sensitivity to its member countries, the Chairman continued. Nevertheless, it was necessary to learn from the incident and to restore a climate of respect for the confidentiality so essential for the Board's discussions. That effort should be made in the expectation that everyone present in the Board Room--management, staff, Directors and their staff--would uphold the trust of those who had placed them there.

On past occasions when he had made similar remarks with a lesser degree of concern, he had invited all those present to consider how to ensure that all persons with access to the Board's work carefully respected its confidentiality, the Chairman recalled. He had mentioned many times--and had repeated on the occasion of the Board's retreat--that he always felt some unease when there were more people sitting behind Directors than were at the Board table itself. Even though he had no doubt that the recent leak had not come from the staff, he wanted to take a step to further reduce staff attendance at Board meetings. He had agreed with the Secretary's proposal that his office would, henceforth, make available to the staff frequent and timely summaries of the thrust of discussions in the Executive Board. Taking into account the further documentation that was available, such as buff statements, summings up, and, as needed, summaries of the discussions, he was certain that the staff would remain abreast of the Board's deliberations and that staff attendance at Board meetings could be reduced to the very minimum needed for full consideration of the items before the Board. That intention would be translated into guidelines for the staff. He was certain that that approach would reduce the Board's exposure to the risk of a breach of confidentiality.

He did not wish to give the impression to the staff that the new procedure was intended to be punitive, the Chairman remarked. Rather, through the streamlining of staff representation at the Board, the staff would be able to devote more time to its regular tasks, which were already overwhelming. He would proceed in that spirit. He would also invite Directors to adopt a similar discipline vis-à-vis their own staff. He would come back to the Board when he had had the opportunity to finalize the guidelines with respect to Fund staff.

As to public pronouncements by the Fund, they remained indispensable in many instances, for example, to marshall public opinion in support of a program, the Chairman observed. In that regard, he would only emphasize the obligation of all spokespersons in their contact with the media to be clear that decisions of the Fund were taken only by its Executive Board or its Board of Governors and that all other agreements reached between Fund representatives and country authorities were on an ad referendum basis.

Mr. Kafka remarked that he fully shared Mr. Fukui's concerns. While management had been successful in reducing, if not stopping altogether, the leak of confidential reports through the system of numbering restricted documents, it might be worthwhile for all concerned to give more thought to how to avoid leaks of discussions, which had previously been rare or non-existent. Perhaps the staff could prepare some suggestions for the Board's consideration on ways to reduce the risk of leaks. He would, of course, be ready at all times to discuss with his colleagues, and with the Managing Director, the question of statements by Fund officials, but that was a much more complicated matter, which could not be easily be resolved by a clear rule.

Mr. Peretz stated that he very much shared Mr. Fukui's concern. In his own memorandum to Directors, he had added yet another concern, namely, the increasing practice of Fund officials of commenting to the press about the content of programs before those programs came to the Board. Mr. Al-Jasser had shared that concern. In both instances of disclosure, he saw a real threat to the Fund's tradition as a nonpolitical, impartial institution--a tradition that he valued extremely highly because it was essentially the strength of the institution.

He welcomed the Chairman's remarks on further restricting staff attendance at Board meetings, Mr. Peretz remarked. He suspected that the main benefit might, in fact, be the reduction in staff time spent in meetings. As to management's reaction to his concern about comments by Fund officials, he retained some doubts about getting the message across to the media that decisions were taken by the Board. In his view, it was too complicated a message for the media. He would prefer instead that there should be no comments at all on programs other than a statement that the matter was expected to be discussed by the Board at a future date. He had, however, noted Mr. Kafka's point that the issue of official Fund comments was a complicated one. While a decision in that regard could not be taken at the present meeting, he would like to return to the issue at a later time.

Mr. Dawson commented that the leak regarding the discussion on Brazil was regrettable. Moreover, he shared the Chairman's view that its source was not the Fund staff. For that reason, he did not favor taking punitive action to restrict staff attendance at Board meetings. That would not send the right message to the staff and might encourage a cloistered, hierarchical approach to access to information in the Fund. The issue was instead self-discipline. Similarly, he did not think that restricting attendance from Executive Directors' offices would be helpful. Self-discipline applied to Directors' offices as well.

The issue of public statements by Fund officials clearly presented a dilemma, Mr. Dawson observed. While it was important for the Fund and its work to be better understood by the general public, reports on what had been "decided" ad referendum on a particular issue often left the Board with the feeling that it faced a fait accompli when a matter was brought for its consideration. He particularly shared Mr. Peretz's concerns in that regard. He was, however, uncertain about what changes needed to be made. When a staff mission or some policy issue received a great deal of public attention, it was unrealistic to expect the staff and management not to comment in some way on developments. At the same time, it had to be made clear to the outside world that agreements reached between the staff and a member country were subject to the Board's approval. He, however, agreed with Mr. Peretz that that message was difficult to convey to the media.

Mr. Filosa remarked that he strongly supported the views of Mr. Fukui and Mr. Peretz. Mr. Fukui had explicitly and concisely explained the potential damage to a member country that could result from a breach of confidentiality. That was a matter of great concern.

As to the Chairman's proposal, he very much agreed with Mr. Dawson that the distance between the staff and the Board, if anything, had to be reduced rather than increased, Mr. Filosa continued. The proposed course would send a general message of distrust to the staff. He therefore believed that further restricting staff attendance at Board meetings was inadvisable. Moreover, it would not prevent someone who wanted to deliberately leak information from attending a particular meeting. He agreed with Mr. Kafka that more thought should be given to what needed to be done, but that discriminatory restrictions on the staff as well as members of Directors' offices should be avoided. Without access to Board discussions, new assistants would find it difficult to become familiar with the Fund's work as well as with the Board's views on particular issues. Perhaps the most efficient solution would be direct surveillance by supervisors. Precise instructions of "no comment" on the details of Board discussions could also be given to the staff.

It was very useful to explain the Fund's general policies to the public, Mr. Filosa considered. For instance, the strategy on Eastern Europe needed to be better understood by the public. But that did not imply the disclosure of the positions of individual Directors or their doubts with respect to a particular program or case. Such disclosures should be formally prohibited.

Mr. Evans stated that he wished to assure Mr. Fukui that he shared his concerns about both the particular episode and about the more general problem. He also shared the additional concern expressed by Mr. Peretz, including the reference in his memorandum to the particular circumstances of the Philippines; he agreed with Mr. Peretz's assessment of that situation. He also strongly shared the views expressed by Mr. Dawson. He did not believe--and his experience confirmed--that the problem of unauthorized disclosures would be solved by the particular measures that the Chairman had proposed, and he would urge that that proposal be reconsidered. In his view, the effective functioning of the Board and the Fund required staff attendance at Board meetings, including some staff who were not involved directly in a particular case. Indeed, the whole operation of the Board and the giving of trust to management and the staff to reach agreements with member countries required that the staff be well informed of the Board's current views.

He agreed with Mr. Peretz that Board decisions should not become a mere formality, Mr. Evans commented. A statement to the media, however, was unlikely to alter the perception that had grown up in that regard. It was up to the Board to demonstrate that its approval was not a mere formality, not least by the attendance of Directors at meetings of substance, but also by the procedures that it adopted for consideration of programs. He had maintained for a long time that the Board needed to change those procedures, and he did not think that the general perception of the Board's role could be altered without doing so.

Mr. Fridriksson remarked that he strongly supported the concerns expressed by Mr. Fukui and the additional points emphasized by Mr. Peretz. He also very much agreed with the statement of Mr. Dawson. In particular, he was concerned about the institution being seen as taking punitive action against the staff in the current instance. He would also join with Mr. Evans in urging that the Chairman's proposal on restricting staff attendance be reconsidered. Management might instead draw the attention of the staff to the recent breach of confidentiality in a special note.

Mr. Dawson observed that his experience in dealing with leaks, including two years in the White House, suggested that they rarely originated with disinterested parties; they were made by interested parties. Restricting staff attendance at Board meetings was therefore unlikely to prevent the problem and might deprive the staff of valuable exposure to the Board's thinking. The key was self-discipline, and management in its relationship with the staff as well as Directors in their relationship with their staffs should make it clear that such breaches of confidentiality threatened the effectiveness of the institution.

Mr. Mohammed commented that his own experience on the staff convinced him that the staff, particularly in the field, was cautious, prudent, and most disinclined to speak publicly. Staff members ran into a difficulty, however, when country authorities pressed them to make a statement. That seemed to happen particularly in countries where the authorities had not yet established the credibility of their own staff; the Fund staff, they hoped, would provide that credibility. In his view, it was for Directors to advise their authorities to refrain from putting Fund staff in a position where it had to comment publicly on its discussions with member countries.

To some extent, the fact that other institutions with which the Fund might be working closely did not have the same degree of interest in maintaining the confidentiality of their discussions with members or did not have an Executive Board with similar decision-making roles also put the Fund staff under pressure to make public statements, Mr. Mohammed observed. In those instances, he would suggest that the Fund work in parallel with the World Bank as well as with other international institutions to instill a similar degree of respect for the decisions of their respective Boards.

Mr. Al-Jasser stated that he shared the views of Mr. Dawson and Mr. Filosa, among others, on the restriction of staff attendance at Board meetings. Staff attendance was, in his view, already restricted, and he was doubtful that there was any need for a further tightening. As to statements made to the press by the Fund staff or management, his views paralleled those of Mr. Peretz more than those of Mr. Dawson, largely because of the many instances when the staff had been quoted as saying "the Fund has approved..."; if staff members had been under pressure, they could have merely indicated that "progress was being made." He took Mr. Mohammed's point that Directors should convey to their authorities the need not to pressure the Fund staff into public pronouncements and should explain to them that it was not the staff's role to lend credibility to the country's economic policy discussions. Nonetheless, he still favored Mr. Peretz's proposal on dealing with the press until some better proposal emerged.

He wondered whether there was some way to identify the individual responsible for the leak, Mr. Al-Jasser commented. Doing so could help discourage further deliberate disclosures. The culprit should be the means to convey to all that unauthorized disclosures of information did not pay.

Mr. Goos remarked that he certainly shared the concerns expressed by Mr. Fukui and Mr. Peretz, but at the same time he tended to side with Mr. Dawson on not further restricting the attendance of staff in the Board, for one reason. Staff attendance had already been considerably limited for the Board's discussion on Brazil. The recent leak proved that such restrictions were no safeguard against such disclosures in the future.

As to public statements of Fund officials in general, while it was possible, in certain instances, to avoid public discussion of program negotiations, if authorities were interested in encouraging such discussion, it was especially important for the staff concerned to make clear that final approval of any agreements reached with the authorities rested with the Executive Board, Mr. Goos considered. That would avoid creating the public impression that once a letter of intent was agreed with the staff, for example, everything had been settled and money would be disbursed in a fortnight. If that approach was followed, the Board would perhaps not be so concerned about public statements by Fund officials.

Mr. Kabbaj commented that while he shared the views of Mr. Peretz and Mr. Fukui regarding the recent disclosures, he agreed with Mr. Dawson that the staff should not be further restricted in attending Board meetings. There were, however, two areas in which some steps might be taken. The first concerned the disclosure in newspapers on many occasions of the full thrust of the Board's discussion of policy matters; proposals should be made to address such leaks of Board discussions. As to the second area--namely, statements by Fund officials--the staff should have some latitude to comment publicly, but in order to shield the staff, management should perhaps review current policies in that regard. He understood that the staff was not allowed to publish an article or to make any public statement unless it was first cleared by the External Relations Department. Despite that policy, problems had arisen. For that reason, and to avoid situations such as Mr. Mohammed had described, management should give clear instructions to the staff on dealing with the public.

Mrs. Martel stated that she shared Mr. Fukui's concern and supported his views on the recent leak. She also agreed with many previous speakers that the confidentiality of Board discussions should be protected. As to the proposal to restrict attendance at Board meetings, she agreed with Mr. Dawson that the solution lay more in self-discipline than in further restrictions on the staff. On public statements by Fund officials, she shared Mr. Dawson's view, but like Mr. Kafka, she considered that it was a complex issue, which should be given further reflection before any decision was taken.

Mr. Peretz remarked that he wished to clarify his position. If a consensus emerged that did not favor restricting staff attendance in the particular context under discussion, he would join it. Such restrictions would give the wrong message to the staff. He also agreed with other speakers that it was doubtful whether a member of the staff was responsible in the current instance. He shared the Chairman's views about the number of persons present for Board discussions, both from offices of Directors and from the staff, partly because there was a risk that a large audience would formalize the way the Board behaved. Moreover, the large number of non-Board attendees represented a considerable budgetary cost. In the circumstances, self-discipline was perhaps the answer. A particular staff member with a need to be present at a Board meeting should be there.

As to Mr. Mohammed's point about country authorities bringing pressure to bear on Fund staff to make public statements, it would help protect Fund staff from such pressures if there were some general rule, for example, that the staff should make no statements to the press, Mr. Peretz observed. The staff would then be able to refer to the practice established under that rule. He agreed with Mrs. Martel and others that the issue of statements by Fund officials was a complicated one and should be discussed further at a later time.

Mr. Dawson commented that his position did not differ significantly from that of Mr. Peretz. Perhaps Mr. Mohammed had best described the circumstances which often gave rise to public statements by Fund officials. The Board should return to the proposal, with a view to avoiding such statements unless warranted by exceptional circumstances. At present, a staff mission gave rise to an expectation that a statement might be made and the absence of one was taken as a negative.

Mr. Kafka remarked that before the Board took a decision on whether to recommend to the Managing Director to restrict the attendance of staff or whether itself to restrict the attendance of Directors' assistants, it should consider whether leaks were the consequence of deliberate action or whether they were often the consequence of carelessness, for example, an inadvertent comment at a cocktail party. Restricting opportunity should also restrict the commitment of the crime. On public statements, he recalled that the Fund's <u>Rules and Regulations</u> already provided that no staff member should make any public statement without the express authorization of the Managing Director.

Mr. Fukui stated that he wished to emphasize the uniqueness of the leak under discussion; it was, he believed the first instance of disclosure of a Board discussion. In that light, he would prefer to consider the matter further at an appropriate time, including the issue of staff attendance at Board meetings. Consideration of the latter issue was not meant to express distrust of the staff, but to underline that attendance of the Board must be taken seriously because it involved confidentiality.

As to public relations, the Fund's policies in that regard must be strengthened, Mr. Fukui considered. Moreover, with the recent and continuing influx of new staff members, it was important to give good guidance to them on the matter of confidentiality, particularly with respect to Board discussions. In closing, he wished to express his appreciation to management for its prompt, positive, and productive response to the concerns he had raised.

The Chairman stated that he was grateful for Directors' remarks. The Board would, of course, have opportunities to come back to the issues that had been raised. He would, however, like to clarify that the disclosure of the Board's discussion was not the first in the Fund's history, although it was the first in its recent history. In any event, Directors had strongly agreed that such disclosures were unacceptable and that the Board attached the highest importance to the principle of confidentiality.

That being said, he wished to correct the impression that his proposal was intended to be punitive toward the staff, the Chairman continued. As he had stated earlier, he did not believe that the leak had come from the staff. His intent was merely to take advantage of the incident to reduce the risk of future leaks. Also, from the perspective of cost--in terms of staff time as well as dollars--some changes were desirable. He was therefore seeking, through the Secretary, to ensure that the staff was fully informed of what took place in the Board at a lower cost. His proposal should in no way reduce the quality of relations between the Board and the staff: the goal was efficiency, and if the byproduct was to reduce the risk of breaches of confidentiality, so be it. He urged Directors, in view of his continuing efforts to rebuild staff morale, not to allow any misunderstanding to develop regarding management's intentions in that regard. He welcomed the confidence that Directors had shown in the professionalism of the staff, and he would continue to remind the staff of the need to be particularly scrupulous in respecting the Fund's confidentiality.

Short of a confession on the part of the culprit, he had little hope of identifying the source of the leak, the Chairman commented. Hercule Poirot himself would have the greatest difficulty there. Nor was it for him to suggest ways to restrict the attendance of Directors' staff at Board meetings. Directors might, however, wish to review whether a certain degree of streamlining could be useful.

On public statements by staff and management, having previously headed an institution which had abstained from giving press conferences for 38 years, he would be delighted if the Fund could be totally silent, the Chairman stated. He could also confirm Mr. Mohammed's view that the staff was disinclined to speak publicly. But, in view of the nature of the Fund's work and the world press, absolute silence was not in the interest of the Fund. Indeed, he could give several examples of instances where a public and forthright statement on the part of the Fund had helped to gain credibility for a member's program, catalyze needed resources, restore a positive dialogue with the member, or shore up confidence in the international financial system. There were also moments when it was in the interest of the Fund to speak in order to make the facts clear and deter those outside the Fund who would like to speak on its behalf. Thus, a degree of discretion was needed in such matters.

He would remind the staff of the obligation, whenever speaking publicly, to make crystal clear that nothing was final until the Executive Board had decided the matter, the Chairman remarked. He himself did that frequently, although generally that was not what captured the attention of the news media. Of course, the media could not be prevented from reporting that something was final, and the staff had to be prepared to react strongly and in an unambiguous way in those instances.

Mr. Al-Jasser stated that he would be the last to call for the Fund to be silent. The fact that the institution had an External Relations Department and a vocal Managing Director with a recently renewed term meant that the Board recognized that there was a need for the Fund to contribute to a better understanding among the general public of its role. Indeed, following every Board discussion on an arrangement for a member country, a press release was issued stating what had been decided. The issue that Mr. Peretz and he, among others, had raised related instead to reports that the Fund had approved a matter even before the Board had considered it. The prepared, deliberate statements by management, the External Relations Department, or other Fund officials were not at issue.

Mr. Peretz remarked that he could agree that there were sometimes good reasons for speaking to the press, but he considered that statements could often be delayed until after the Board's discussion of the matter. His concern, which closely reflected Mr. Dawson's, was that increasingly there was a presumption that a statement of some kind would be made by a Fund mission at the end of its discussion with country authorities and that the absence of such a statement might be seen as something of a black mark. He supported Mr. Dawson's suggestion to move back to a position where the presumption was that no such statement would be made; instead, the staff would indicate only that discussions were being concluded and the matter would be discussed by the Board in due course. Of course, there would be occasions when it would be sensible to depart from that practice, but those occasions would be considered carefully and would be approved by senior management. He agreed with other Directors that the entire issue of relations with the media should be considered further at an appropriate time.

The Chairman stated that he agreed with the presumption that, as a rule, public statements would not be made at the end of an Article IV consultation discussion or a negotiation on the use of Fund resources. Indeed, that had been the practice in the majority of cases. The problem was that there were exceptions. For instance, governments might want to leak the conclusions of an Article IV consultation, and they were clever in doing that. Moreover, in the course of a negotiation, a number of persons not only from within the government but also advisors from the private sector, who were anxious to distance the government from the Fund's policy recommendations, were also present. In those circumstances, the staff frequently had to speak--sometimes without management clearance--because it found itself on the spot in the midst of reporters. Efforts were, of course, made to educate the heads of missions on ways to handle such situations so as to avoid any disclosure of a confidential nature. He would not, however, wish to see the presumption of silence given a strongly legal formulation, because some latitude for discretion was necessary to avoid misunderstandings about the Fund and its work. Directors should, however, be assured that management would confirm all the principles governing staff conduct in its relations with the general public.

4. ZAMBIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Zambia's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund, effective September 30, 1987 (EBS/92/25, 2/12/92).

The staff representative from the African Department recalled that the staff paper indicated that the January 1992 increases in oil prices had brought them fully in line with costs. Subsequently, oil prices had been raised a further 30 percent, thereby passing through fully the devaluation that had occurred at the end of January.

The staff representative from the Treasurer's Department stated that Zambia had paid the quarterly charges due on February 14, 1992, which brought payments made since the previous review (EBM/91/137 and EBM/91/138, 10/2/91) to SDR 18.9 million.

Mr. Mwananshiku made the following statement:

> At the outset, I would like to express to management and to the staff the appreciation of my Zambian authorities to management and to the staff for responding promptly to their invitation for a staff visit to Lusaka in November 1991, which helped them to articulate their economic and financial policies for 1992 and the medium term. My authorities deemed it particularly important that they do so immediately following their success in the recent multiparty elections. In their view, it was important to give an early and clear signal, both domestically and externally, about the direction of future economic policies. In that context, they had decided to move more decisively on some key, sensitive issues. Directors will recall that action on some of those policy issues was suspended in the period prior to the elections, which contributed to the worsening budgetary performance in 1991.
>
> As reported by the staff, the new Government announced a substantial increase in the consumer price of maize meal, Zambia's main staple food. In making this announcement, the Minister stressed that the Government intended to eliminate subsidies completely by the end of this year, while liberalizing the producer price of maize and the consumer price of maize meal. He emphasized that the new Government seeks to redefine its financial and economic priorities and to redirect resources toward more productive sectors. This action was accompanied by equally strong measures that involved not only the strengthening of accountability in the parastatals, but, more specifically, raised prices that had been unadjusted for some time, for example, petroleum prices. I can also confirm that petroleum prices were raised by an additional 30 percent last Saturday.
>
> Against this background, my authorities have tightened their financial policies, with the overall budget deficit in 1992 targeted at slightly less than 2 percent of GDP. This is in line with the objective set out in the 1992 program and in the last policy framework paper. The measures designed to achieve this objective have been clearly enumerated in the staff paper. They involve a wide range of expenditure restraint and important revenue-raising and tax reform measures.
>
> The main objective behind these policy initiatives is to revive the program that went off track in the period prior to the October elections. The new Government is determined to establish its own track record in program implementation. In announcing the

budget, for example, the Minister of Finance emphasized the need to continue the reform program and to implement its measures more diligently and in a more timely and consistent manner.

In the light of the budget announcement and the actions already taken, it has become clear that the program, as envisaged in the last policy framework paper, has been given a new lease of life and that payments to the Fund can be accelerated. Thus, with the clearance of arrears to the World Bank, a process has begun to unlock the much-needed external financial assistance. Accordingly, a significant payment was made to the Fund to bring arrears to their end-1991 level. Further bilateral assistance has resumed, which should help Zambia to acquire additional SDRs so as to ensure that it remains current on obligations falling due to the Fund in the coming months. It is my sincere hope and that of my authorities that the forthcoming Consultative Group meeting will provide Zambia with adequate support on highly concessional terms as called for in the proposed decision. Zambia would subsequently be in a position to revive its rights accumulation program by the middle of this year.

In closing, my authorities have asked me to report to the Board that subsequent to the preparation of the 1992 program, it has become clear that Zambia, along with other countries in Southern Africa, is experiencing one of the most severe droughts in recent memory. The disaster has affected the main food-producing provinces in the country. My authorities have indicated that the food import requirement will be substantial and that they need urgent foreign assistance. The forthcoming staff mission will have an opportunity to assess with the authorities the precise implications of the drought and any further action that may be deemed necessary.

Mr. Peretz said that he welcomed the speed with which the new Government, acting with the full moral authority that came with being an elected government, had acted to address a difficult economic situation and had relaunched the recovery program. A number of bold, and overdue, steps had been taken, including sharp increases in domestic maize and oil prices as well as sharp rises in interest rates. Moreover, the recent budget was quite rightly a very tough one. In the area of structural reform, the authorities were trying to recover rapidly the ground lost over the past year. He also understood that World Bank staff had felt a need to temper the authorities' enthusiasm to move rapidly to privatize parastatals.

The Zambian authorities had cleared the fresh arrears to the World Bank and had reduced arrears to the Fund to their end-1991 levels, Mr. Peretz continued. They had also made an advance acquisition of SDRs to meet the payments falling due to the Fund in the months ahead.

It was most important that the momentum of those efforts be sustained by appropriate signs of support from the international community, Mr. Peretz stated. His own authorities, like other donors, had unfrozen their program aid. He hoped that the Fund and the Bank could move quickly and in parallel to get Zambia back on the path to normalizing its relations with its creditors. The extent of Zambia's problems would demand exceptional efforts by all concerned. In addition, a certain degree of flexibility on the Fund's part would be warranted as long as the authorities maintained the current degree of commitment to their reform program. In particular, it would be important that when the Board agreed on a rights accumulation program for Zambia, it set realistic objectives and gave the authorities adequate incentives to persevere with their difficult task.

The problems in Zambia would not be made any easier by the drought, which might have a severe effect on the current maize crop, Mr. Peretz observed. There was little consolation in the fact that the problems caused by the drought would have been much worse had the Government not acted rapidly to raise maize prices and to secure fertilizer supplies.

He understood that the rights program would not be formally relaunched until July in order to allow the authorities time to re-establish a track record of policy and payments performance, Mr. Peretz continued. That approach was probably sensible, but he very much hoped that credit would be given to Zambia for performance in the period prior to end-July, by granting it some upfront accumulation of rights at the time when the program was approved and by taking account of that period when deciding the length of the rights accumulation process.

If other Directors could agree, he was ready to amend the proposed decision so as to waive special charges for Zambia with immediate effect, Mr. Peretz remarked. That would, in his view, be entirely appropriate given Zambia's agreement to stabilize its arrears to the Fund. Moreover, it would reduce Zambia's debt service to the Fund by about one fifth. If, however, other Directors could not support that proposal, he was prepared, reluctantly, to leave the issue until the Board's general review of special charges in April. His preference, however, would be to take an immediate decision in Zambia's case.

He looked forward to seeing Zambia's new policy framework paper, Mr. Peretz commented. He hoped that time might be found for the Board to discuss the policy framework paper, perhaps informally, ahead of the Consultative Group meeting in late March. Subject to his preference with respect to special charges, he could support the proposed decision.

Ms. Powell stated that she very much welcomed the courageous measures recently taken by the Zambian authorities. She was encouraged by their determination to bring the adjustment program back on track with a view to reviving the rights accumulation process. She cautioned, however, that it was absolutely crucial that there be no further slippages in policy implementation. Only a solid track record could lay the basis for a rights accumulation program and for the strengthening of donor and creditor confidence.

The recent positive developments in Zambia underscored the need for a good deal of flexibility and pragmatism under the strengthened arrears strategy, Ms. Powell considered. With that in mind, she fully supported Mr. Peretz's suggestion that special charges again be suspended in the case of Zambia. Clearly, continued application of special charges would add to the financing requirements of Zambia's program. Perhaps more important at the current juncture, the suspension of special charges would represent a tangible demonstration of support for Zambia's renewed commitment to adjustment and its cooperative stance vis-à-vis the Fund.

She had a procedural question in the event that the Board chose to suspend special charges in the case of Zambia, Ms. Powell continued. Executive Board Decision No. 9723-(91/63) G/TR, adopted April 24, 1991, stated that for Zambia, the suspension of special charges would come into effect when its overdue obligations to the Fund were equal to or below SDR 836.9 million. More generally, the decision further stated that if a member failed to make payment of any newly maturing obligation, "the member shall be subject to special charges on the total of its overdue repurchases and charges in the General Resources Account to which special charges are applicable for as long as such payment is not made." Zambia had missed payments in 1991, and its overdue obligations currently amounted to SDR 921.5 million. If a consensus emerged favoring the suspension of special charges with immediate effect in the case of Zambia, she wondered whether the Board would be constrained by the April 1991 decision.

On balance, she was inclined to concur with Mr. Peretz that it might not be feasible to achieve a consensus at the current meeting on waiving special charges, Ms. Powell remarked. Rather it might be necessary to await the annual review of the system of special charges, at which time the Board could review Zambia's changed circumstances. At the very least, however, she would like to see the decision reflect the fact that the Board intended to consider the suspension of special charges on Zambia's overdue obligations at the time of its annual review of the system of the special charges.

Mrs. Martel stated that she welcomed the positive and courageous economic measures adopted by the Zambian authorities since the October 1991 elections. Among those actions, she noted in particular the significant increase in maize prices and the restrained budget that had been presented for 1992, which aimed at reducing the primary deficit to 2 percent in 1992 and tightening monetary policy.

The new stance of macroeconomic policies was particularly welcome after the large slippages that had occurred in 1991 and had led to a rapid deterioration in the fiscal and monetary situation, Mrs. Martel continued. In fact, a shortfall in tax payments and import duty collections together with higher than programmed subsidy and wage bills had led to a primary budget deficit of 7 percent of GDP. Central bank financing of that deficit had, in turn, fueled inflation, which had risen above 100 percent by the end of 1991. Because of those slippages, the rights accumulation program approved in April 1991 had rapidly gone off track, the review under Zambia's rights program was not concluded, and Zambia accumulated no rights.

Those slippages had resulted in a significant increase in Zambia's overdue obligations to the Fund, Mrs. Martel commented. The programmed level of arrears for end-1991--SDR 836.9 million--was far from being attained, and further overdue obligations had accumulated, exceeding the program ceiling by about SDR 80 million. Despite the recent settlement of SDR 18.9 million that was achieved with the active support of the international financial community, arrears had increased by SDR 16.1 million since the previous review in October 1991. The further accumulation of arrears was regrettable, and in that regard, she noted that the proposed decision did not reflect the disappointing deterioration of Zambia's payments performance.

As to future relations with the Fund and, in particular, the question of a revised rights accumulation program for Zambia, she wished to recall that her chair supported the rights approach and all its basic guidelines as an important part of the strengthened cooperative strategy on overdue financial obligations to the Fund, Mrs. Martel stated. It was therefore crucial for the Fund that the necessary conditions to resume the rights accumulation program be met. Another failure, especially on the part of the first country to have benefitted from a rights accumulation program, could seriously undermine the credibility of the Fund's strategy. As a basic principle for judging the extent to which a member in arrears was cooperating with the Fund, the Board should pay particularly close attention to the establishment of a satisfactory track record on payments and on macroeconomic adjustment policies. Even though the measures recently adopted by Zambia were encouraging, the Board should bear in mind that for more than a year, the international financial community--namely, the Bretton Woods institutions and Paris Club creditors--had made considerable efforts in favor of Zambia.

At the current stage, and with those considerations in mind, her authorities were not ready to contemplate favorably a waiver to suspend special charges on Zambia's overdue obligations, Mrs. Martel continued. Moreover, she agreed with Ms. Powell that granting a waiver would require a modification of the ceiling adopted in the April 1992 decision. In any event, while her authorities had no doubts regarding Zambia's willingness to cooperate with the Fund and were concerned about the need to promote the adoption of a credible program, they could not envisage a modification of the July 1, 1990 level of arrears and the front-loading of rights upon approval of a new program.

She welcomed that an active dialogue between Zambia and the Bretton Woods institutions had been restored, Mrs. Martel commented. Together with the commitment of the new authorities to implement corrective macroeconomic and structural reforms, that active cooperation was an encouraging factor for the normalization of Zambia's relations with donors and creditors.

Mrs. Krosby remarked that since the last Board discussion on Zambia, its performance on payments to the Fund and on the adoption of appropriate economic adjustment policies had improved markedly. Obligations that had fallen due so far in 1992 had been paid, and action had been taken to address obligations falling due through April. A responsible budget that would fit neatly into a rights accumulation program had been presented and included much-needed steps to eliminate subsidies, reform the tax system, and improve parastatal operations. Some key fiscal measures, including significant price increases of subsidized goods, had already been taken, giving a clear indication of the new Government's determination to act on its promises. Emergency measures to rein in money growth and restore competitiveness had been also been enacted.

Zambia had recently reinstated itself with the World Bank, using donor and commercial bank bridge financing to clear its arrears, Mrs. Krosby observed. Those funds had been provided based on the strength of the 1992 budget and the actions taken thus far. The authorities were aware of what was needed to restore their relationship with the international financial community, and she urged them to continue to move forward with their reform program.

Tempering her enthusiasm, however, was Zambia's history, Mrs. Krosby commented. To set the first rights program in motion, the Fund and donors had gone through gymnastic contortions, making substantial allowances to forgive policy slippages and taking a liberal approach to payments. For that reason, it was cause for some concern that Zambia's overdue obligations to the Fund had increased in the intervening period, so that it appeared that the new ceiling on arrears for the rights program and for qualifying for suspension of special charges would be the end-December 1991 level.

She recognized that the new Government, which seemed to enjoy strong domestic support, had moved quickly to improve Zambia's standing with the Fund, and she was hopeful that the program would move forward as planned, Mrs. Krosby stated. In view of Zambia's record, she believed that a six-month period to give the authorities time to implement a strong adjustment program so as to ensure that a new rights program was soundly established was appropriate. However, she hoped that good performance during that period would be taken into account in establishing the duration of the new rights program.

She could agree with the proposed decision, Mrs. Krosby concluded. Her chair would like to be kept fully apprised in the intervening period, perhaps through informal meetings, of progress in putting the program in place.

Mr. Esdar remarked that it was encouraging that the new Government of Zambia had decided to re-embark on the adjustment course. Some crucial measures had already been implemented or decided upon to address fiscal slippages, and there was an urgent need to put fiscal consolidation at the core of the program. He therefore welcomed that the budget presented for 1992 was in line with the understanding of the overall program.

In that regard, the decisions to reduce subsidies and to increase consumer prices for maize as well as domestic prices for energy were important elements to overcome fiscal imbalances, Mr. Esdar considered. On the revenue side, besides the projected significant growth in nontax revenue, the reform of the income tax system and the introduction of the value-added tax were important steps. In the framework of the reform of the income tax system, a reduction of personal tax rates and a substantial rise in the level of tax-exempt income was envisaged. That might lead to substantial revenue reductions. Therefore, the timing of the introduction of a new tax system as well as the balancing of revenue and expenditure elements of the reform seemed to be crucial to avoid slippages in the fiscal adjustment. He would appreciate more information in that regard, particularly on the balancing of the two elements he had noted.

He supported the planned course of action with respect to monetary policy, Mr. Esdar commented. However, the envisaged inflationary outcome of 45 percent underlined the need for further consolidation. The elimination of monetary financing of the budget and the maintenance of positive real interest rates should be given the highest priority. In view of the encouraging steps that had been taken, he looked forward to seeing the overall economic program presented in a revised policy framework paper.

He could support the proposed decision, which reflected in a balanced manner the fact that the adjustment process had regained some momentum and the concern that since the last review arrears had increased again, Mr. Esdar remarked. There was an urgent need to address the issue of arrears payments. As to Mr. Peretz's proposal to suspend special charges, he wished to reserve his position and looked forward to hear the staff's response in that regard. As to possible front-loading of rights, he shared the view of Mrs. Martel that the Board should take care to avoid the frequent modification of its arrears strategy.

The staff representative from the African Department, commenting on the drought in southern Africa, stated that she understood from conversations with Lusaka that prospects were highly uncertain at present. The authorities had been awaiting the rains for the past two to three weeks. In their view, if the rains came that week, the situation might be saved; if, however, the drought continued for another two or three weeks, the entire crop might be lost. In a worst-case scenario, additional financing requirements owing to maize imports might exceed the amounts envisaged in the program by about $200 million. There was grave certain that supplies of maize would not be available in the region. Zimbabwe expected that it would have to import maize, and she understood that South Africa's maize production was expected to show a shortfall. Thus, the region might be facing a major food shortage problem.

Tax reform had been a central issue throughout the staff's discussions with Zambia, the staff representative remarked. Under the current system, salaries were taxable, and any benefit--even if it was given in cash as a percentage of salary--was tax exempt. Over time, benefit increases had replaced salary increases: as much as two thirds of total remuneration was estimated to be tax exempt. Under the new system, all remuneration in cash was taxable to the employee and remuneration in kind was not deductible as an expense to the employer. At the same time, tax rates were being cut. The reform was designed to be revenue neutral so as to avoid having a significant impact on real incomes and thus setting off a spate of salary increases. The estimate of revenue neutrality was based on a statistical sample of the civil service. Although no data were available, it was believed that fringe benefits as a share of total remuneration was even higher in the private and parastatal sectors than in the civil service. The reform could, therefore, have a positive impact on revenue when the private sector was taken into account. While recognizing that the introduction of a radically different tax system carried some risks, the staff considered that the reform was essential to re-establish a viable income tax system.

In the coming weeks and months, the staff would be discussing Zambia's exceptionally large financing needs with the donor community, the staff representative from the African Department observed. All sides were likely to be more forthcoming if each party indicated its willingness to act in a similar manner. On the Fund's part, the possibility of a waiver of special charges at an early date would be viewed positively by donors, especially as they were being asked to make an exceptional effort.

The staff representative from the Treasurer's Department remarked that, as Directors had noted, the renewed suspension of special charges for Zambia at a higher level of arrears than originally provided for in the April 1991 decision would require an amendment of that decision. In that context, he would further note that the Executive Board would be reviewing the system of special charges, including the suggestions of some Directors for major modifications to the system, in April 1992.

Mr. Peretz observed that the consensus appeared to favor a delay of any waiver for a period of two to three months. In that event, he wondered whether the waiver of charges could be backdated. While the staff might wish to hold that possibility up its sleeve during its discussions with the authorities and donors, it would be reassuring to know that if a decision was taken to waive special charges, it could be backdated, say, to February 19, 1992.

The staff representative from the Legal Department stated that although the matter would have to be considered further, the Executive Board could, at the current meeting, express its readiness to grant a waiver as of February 19, 1992, in the context of the April review, provided that in April it was fully satisfied with the efforts on the part of Zambia as well as donors.

Mr. Esdar observed that special charges with respect to other countries had also been treated in the April 1991 decision. It would be interesting to know what procedure had been followed with respect to those countries.

The staff representative from the Treasurer's Department recalled that Panama and Peru had fully met the conditions of the April 1991 decision. In the case of Viet Nam, the member had not fully met the conditions under the decision throughout the period, but the staff had been working with the member to reduce arrears to the level specified in the decision. Thus, issues of comparability would arise if the Board were to take a decision to alter the ceiling with respect to Zambia. Moreover, the backdating of the waiver would raise the issue of the treatment of special charges that accrued in the period between the adoption of a decision to waive and the effective--namely, backdated--date of such a waiver. To date, it had not been the practice to forgive obligations already accrued.

Mrs. Martel commented that a decision to modify the ceiling on Zambia's arrears in the absence of a good track record could have negative consequences on the credibility of the Fund's arrears strategy. For that reason, she did not favor taking a decision on the suspension of overdue obligations at the present time. Moreover, paragraph 3 of the April 1991 decision stipulated that the Fund would extend the suspension of special charges to any member if the Fund endorsed a rights accumulation program for that member, and if the Fund determined that the member was actively cooperating with the Fund toward the clearance of its arrears and had undertaken not to increase its overdue obligations above a specified ceiling level. Those two criteria had not yet been met in the case of Zambia.

Mr. Peretz remarked that owing to the criteria mentioned by Mrs. Martel, he had proposed setting a new level of arrears--namely, the end-December level. The Zambian authorities had maintained that level and had also demonstrated that they were cooperating with the Fund. He recognized that that would required an amendment of the April 1991 decision; alternatively, the Board could decide to backdate any decision to modify its policy on special charges in the context of the forthcoming review of the system of special charges.

Mr. Koissy stated that he was pleased to note from the staff paper that since October 1991, the Government of Zambia had made considerable progress in turning around Zambia's deteriorating economic situation by quickly putting in place the main elements of a macroeconomic program for the period 1992-94. The series of actions that had since been taken, especially in the fiscal and monetary areas, were positive developments, which indicated the new authorities' determination to implement the kind of policies that would address effectively the economic problems plaguing the economy and would provide a basis for a resolution of the protracted arrears to the Fund. In that respect, it was most encouraging that Zambia had satisfied the first criterion for judging the extent of its cooperation with the Fund. The envisaged program of adjustment appeared to be on the right track, and he urged the authorities to persevere in its implementation. On the criterion relating to payments performance, he was also pleased to note that Zambia not only had cleared all obligations that had fallen due so far in 1992, including the recent payment on quarterly charges, but also had established administrative arrangements to facilitate the settlement of future obligations through April 1992.

In light of the above, he could endorse the staff proposal that no remedial action be taken at this time, Mr. Koissy remarked. He could also go along with Mr. Peretz's suggestion to waive special charges in favor of Zambia. He therefore supported the proposed decision, amended as necessary to reflect Mr. Peretz's suggestion.

Mrs. Da Costa stated that after serious policy slippages in the implementation of Zambia's rights accumulation program, it was encouraging to hear from the staff that the new Government had taken important measures to return the economy to the path of stabilization and structural reform. She also welcomed the authorities' efforts to settle all obligations falling due to the Fund in 1992. As Zambia had been the first country to avail itself of the rights approach, it would be disappointing if that effort did not have a successful conclusion. She hoped that by midyear the Board would have the opportunity to discuss Zambia's 1992 rights accumulation program.

At the current stage of the discussion, she would make only a few comments, Mrs. Da Costa continued. The Zambian authorities needed to make every effort to send a clear signal to the international financial community and to the Fund of their strong commitment to the economic program. That was the way not only to achieve internal and external stability, but also to regain donors' confidence and financial support. The implementation of the complete set of measures contemplated in the program should be accomplished without delay to guarantee an improvement in the public finances and to bring down the rate of monetary growth so as to reduce the inflation rate and avoid further appreciation of the real exchange rate. Moreover, she had concerns about some elements of the 1992 program described by the staff. Among them, it was not clear why, if there was excess liquidity in the system at end-1991, the rate of monetary growth for 1992 was the same as that envisaged in the program for 1992. It seemed more reasonable to reduce further the rate of growth of the money supply in 1992. Moreover, the poor performance of the public sector in 1991 called for strong actions on several fronts. It was not clear whether the set of measures envisage in the 1992 program could be implemented in time to reduce the deficit significantly, nor was it clear whether the authorities would have the necessary instruments to control the parastatal entities. Another issue that raised concern was the balance of payments outlook for 1992, and the possibilities to reduce arrears to the level prevailing at the time of the approval of the rights accumulation program. She looked forward to a further discussion of those issues, among others, at the time of the Board's consideration of the 1992 program.

She urged the Zambian authorities to continue and strengthen their efforts to stabilize the economy and to solve the arrears problem, Mrs. Da Costa commented. She also urged the international financial community to continue its support of Zambia. She agreed with the staff and previous speakers that Zambia met the two criteria for cooperation with the Fund, and she therefore supported the proposed decision.

Mr. Nakagawa remarked that the recent developments under the new Government in Zambia were encouraging. His chair particularly welcomed the

100 percent increase in the price of maize, as well as the 30 percent depreciation of the kwacha. He strongly encouraged the authorities to further pursue their reform efforts in right directions.

As to a waiver of special charges, during the discussion of the rights approach, some Directors had held the view that a country with a rights accumulation program should try to reduce its arrears during the program period, Mr. Nakagawa recalled. In the spirit of that discussion, his chair would hesitate to revise upward the ceiling on arrears during the rights accumulation program.

Mr. Fridriksson stated that the new Government in Zambia faced a daunting task, having inherited an economy which had been seriously mismanaged over an extended period, even to the point that real per capita GDP in 1991 stood at broadly the same level as 30 years earlier.

At the Board discussion in October, he had expressed deep disappointment about Zambia's performance under the rights accumulation program, Mr. Fridriksson recalled. He was therefore pleased to welcome the decisive steps taken by the new Government so far. While he regretted that arrears had increased since the previous review, he nevertheless welcomed the Government's recent efforts to meet obligations falling due to the Fund.

Whether it would be possible to endorse a new rights accumulation program hinged primarily on the authorities' success in establishing a firm record of policy implementation and payments to the Fund over the coming few months, Mr. Fridriksson observed. Firm adherence to the budget for 1992 was essential in that respect. Generally, the objectives of a new rights accumulation program should be the same as those of the original program and in line with the agreed principles with respect to such programs. He hoped that the Board would have an opportunity to reflect on the possible access under, and duration of, a new program for Zambia before negotiations were concluded.

As to the suspension of special charges, he had sympathy for Mr. Peretz's proposal and for the staff's suggestion that the Fund should have some leeway in discussions with the authorities and donors in the coming few weeks, Mr. Fridriksson commented. Nonetheless, he preferred to look at special charges in general, and at a possible suspension in particular, at the time of the Board review in April. He supported the proposed decision and strongly hoped that it would be possible to present a rights accumulation program to the Board during the summer.

Ms. Powell remarked that she wondered whether it would be helpful, particularly in the context of the staff's discussions with donors, to amend the proposed decision along the line that she had suggested, namely, to indicate that the Board would be prepared to consider the suspension of charges at a forthcoming review.

The Chairman commented that he appreciated Ms. Powell's general point that it was in the interest of the Executive Board to utilize the leverage of special charges to serve its purposes--namely, to promote the adoption by Zambia of a strong program and to catalyze the efforts of the donor community. In that connection, the choice of the vehicle to convey that signal to the authorities and to donors had to be considered. In addition, the legal elements involved had been very well captured by Mrs. Martel and Mr. Peretz. It would, of course, be possible to convey the views and intentions of the Executive Board in a letter from management to the authorities. The choice of vehicle was in the hands of the Board.

Mr. Evans stated that he was in general agreement with the staff's approach, namely, to work toward a new rights accumulation program to be considered around midyear, once the Board had had a chance to consider the track record that the authorities had established in respect of policy implementation and payments, both of which were currently cause for considerable concern. He also agreed with Mrs. Martel's comments on the importance of maintaining the integrity of the rights approach.

As to the issue of cooperation, he agreed that, as far as the program was concerned, there had been an extraordinary change in Zambia's policy performance and that was very much to be welcomed, Mr. Evans remarked. Nonetheless, it was most important that a program was adequate. Looking at the fiscal program, which was fundamental in the case of Zambia, at first glance the program for 1992 appeared to be somewhat stronger than that originally proposed for 1991, and was much stronger than what had been achieved in 1991. Nonetheless, in reality, revenue in relation to GDP in 1992 was to be maintained at a level somewhat below that programmed for 1991, and then only through an increase in foreign grants; tax revenue would fall by over 2 percentage points of GDP. Similarly, although expenditure was to be restrained in 1992, the main restraint came in capital expenditure. It was difficult to be confident that that type of program could yield results which would encourage the authorities to stay the course.

On the payments record, payments had fallen well short of obligations since the last review, Mr. Evans observed. They had been maintained since the start of 1992, but only by payments from the World Bank to the Fund via the Zambian authorities, and that on the basis of the Fund staff advising the World Bank that it had no objections to the Bank making such disbursements to allow the Fund arrears to be met.

For all of those reasons, he saw a need to establish a track record, and he was not in a position to agree to any change to the treatment of special charges, Mr. Evans stated. Moreover, at the time of the review of special charges, he would be loath to agree to any backdating of a decision, but if the consensus supported that approach in respect of all countries in arrears which were cooperating with the Fund, he would consider it.

Mr. Mohammed recalled that his chair had expressed its doubts on a number of occasions regarding the efficacy of the system of special charges. It had done so for several reasons, including one that was implicit in Mr. Peretz's suggestion--namely, that special charges only made more difficult the eventual elimination of arrears. He would therefore have been willing to support Mr. Peretz's initial proposal but could also go along with the proposal as modified by him. If a consensus in favor of such a change was lacking, he would very much support Ms. Powell's proposal to at least give an indication to the authorities and donors that the Fund would be prepared to consider a suspension of special charges on a later occasion.

Mr. Trbojevic remarked that the new Government in Zambia had proven recently that it was very much endeavoring to cooperate with the Fund and other international institutions and to introduce and implement a new adjustment program. He would agree with Mr. Evans that it was important that a track record should be established, and for that reason, he would favor the more flexible idea of waiting a certain period of time before taking a decision on waiving special charges. He supported the proposed decision as it stood.

Mr. Kural stated that two facts indicated that Zambia was making substantial progress toward getting its financial relations with the Bretton Woods institutions back on track: first, its payment performance; and second, the adoption of appropriate macroeconomic adjustment policies. The program undertaken by the new Government seemed to focus on all the key elements needing priority attention. Those policies, which aimed at reducing the budget deficit and controlling the money supply, were fully in line with the Fund's recommendations for countries following stabilization programs.

He wished to focus on potential obstacles to the program's implementation in the short run, Mr. Kural continued. Stabilization measures aimed at absorbing excess liquidity, substantially reducing the budget deficit, and restraining credit expansion were needed to contain inflationary pressures following price liberalization. Firm incomes and budget policies could help control the responses of wages and subsidies to the price increases and decrease the risk of higher inflation. On the external front, the achievement of a solid balance of payment position through the restoration of Zambia's competitiveness would require the pursuit of a realistic exchange rate policy and careful management of external payments.

Zambia's failures during recent years to fully attain its macroeconomic policy goals had been mostly owing to fiscal slippages, Mr. Kural observed. Fiscal correction had been hindered not only by the difficulty of reducing the central government borrowing requirement but also by the financial weakness and economic inefficiency of the parastatals. He therefore welcomed the recent measures eliminating the subsidies on maize meal and petroleum products and initiating a fundamental reform of the income tax system. Those measures should be complemented by a careful review of the spending programs of the Central Government and the underperforming parastatals in order to identify spending cuts and candidates for privatization based on specific priorities. Obviously, using the parastatal holding company (ZIMCO) as a channel for offsetting the losses made by some parastatals with the profits made by others had been the cause of both lower nontax revenues and of resource misallocations leading to inefficiency. He therefore also welcomed the recent measure establishing a much firmer policy on mandatory dividend payments from parastatals to the Government. It should be emphasized that regardless of donor support, the fragility of Zambia's external position would clearly require that the authorities exercise great caution in implementing their program of privatization in the context of a full-fledged market economy.

The highest priority for monetary policy at the outset of the new Government's program would be the absorption of sufficient excess liquidity to achieve the targeted $35 million buildup in foreign reserves and the 25 percent limit on money supply growth, Mr. Kural considered. In that connection, the authorities' recent progress toward formulating and implementing an appropriate economic adjustment program as well as Zambia's recent payment performance were steps in the right direction.

In sum, Zambia's progress with the structural and payments aspects of its program should be consolidated by the pursuit of selective programs of expenditure reduction and tax system reinforcement to keep the fiscal program on track, Mr. Kural stated. Zambia's economic priorities clearly called for sacrificing current consumption in order to achieve more rapid structural development and stronger future growth. That being said, he had some doubts about the suspension of special charges. He supported the proposed decision.

Mr. Wei remarked that he was in broad agreement with the staff analysis of Zambia's economic situation. Therefore, he would offer only a few brief remarks.

He was pleased to learn from the staff paper that, since assuming office in late October 1991, the new Government was determined to take effective measures to cope with economic issues and had made every effort to normalize relations with international financial institutions, including the Fund, Mr. Wei continued. The Government intended to limit the primary budget deficit to 2 percent of GDP, reduce subsidy bills, adjust the prices of some products, as well as enact other policy changes. In his view, controlling government expenditure was key to the success of macroeconomic adjustment.

He was aware of the difficulties confronting Zambia while it undertook many important changes within the various sectors of the economy, Mr. Wei commented. The authorities should be allowed sufficient time to implement and adjust to those policy reforms, including any new issues that might emerge during the course of implementation. During that period it would be helpful for Zambia to be able to receive assistance from the international community. Any initiative from the Fund in that respect would have his support. He hoped that the authorities would persist in their policy reforms in order to make good progress in adjusting Zambia's economic structure.

He understood that Zambia was facing severe difficulties and that the authorities were making efforts to repay the Fund, Mr. Wei remarked.

Although the amount of the recent repayments was not great, it was a good indication of the Government's intentions. The issue of the suspension of special charges should be viewed in that light, and the Zambian authorities should be encouraged to normalize their relations with the international community as soon as possible.

The Government was trying to remove all subsidies, particularly for maize, which was the staple food of Zambia, Mr. Wei observed. He wondered how the poor could afford to buy maize when its price had been increased overnight by 100 percent. As social stability was important to guarantee the smooth implementation of the Government's economic reforms, he would appreciate staff comment on that issue.

Mr. Esdar, recalling that he had reserved his position on the suspension of special charges, stated that in light of the discussion thus far and the staff's responses, he had some doubts as to whether a suspension would be appropriate at the present time. He would prefer to come back to that issue in the context of the Board's general review of special charges. As to informing the authorities and donors of the Fund's readiness to modify its decision on special charges as part of the global effort to assist Zambia, although he had some doubts regarding that approach, he could go along with the consensus.

Mrs. Martel remarked that her chair, like Mr. Mohammed's, had stated many times that there were good reasons for suspending all special charges. In the case of Zambia, however, the question was not one of principle but rather one of modifying the level of arrears. In her view, there could be no such modification for the reasons she had given earlier. The idea of conveying to the authorities and donors that the Fund was prepared to consider the suspension of special charges in the coming few months was a good one, as long as the communication also indicated that the suspension would be subject to a good track with respect to payments and performance as well as to meeting all other conditions set out in the April 1991 decision.

Mr. Bossone stated that he was gratified to see that since the previous Board review of Zambia's overdue financial obligations to the Fund, a fundamental change in attitude had taken place at the political level. Important fiscal and monetary measures had been taken by the new Government since it took office in November 1991 and, even more important, the information provided by the staff confirmed that the authorities were fully committed to bring the adjustment process back on track after the serious policy setbacks that had occurred in 1991.

It was necessary, especially in light of the more difficult external financial and economic environment confronting Zambia, that the signal from the authorities be one of firmness in complying with the programmed policy requirements, Mr. Bossone considered. The authorities should be made fully aware that there was no room for further slippage in policy implementation, and that the consequences of missing the envisaged policy targets would be extremely high for the country to bear, both in terms of the erosion of international support and future adjustment costs.

In the period up to the Board's consideration of a rights accumulation program for Zambia around midyear, the authorities should establish an acceptable policy track record that could convince the international community of their intention to fully cooperate with the Fund, Mr. Bossone commented. To that end, he urged the authorities to exploit all the opportunities available and to do all in their power to avoid policy slippages that would seriously compromise their chance of overcoming the current difficult phase. He could support the proposed decision as well as the suggestion to convey to the authorities and donors the Board's intention to consider the suspension of special charges in the near future.

Mr. Zoccali stated that he welcomed the re-establishment of the adjustment momentum by the new Zambian authorities, and, in that context, he was fully prepared to support the proposed decision.

On the treatment of special charges, his chair was among those that had expressed doubts regarding the usefulness of special charges for enhancing the possibilities of collecting outstanding arrears to the Fund, Mr. Zoccali recalled. Like Mr. Evans, however, he believed that that question should be considered keeping in mind the integrity of the current strengthened arrears strategy. Therefore, the April review seemed to be the appropriate opportunity for sending a clear signal on the subject that would be applicable to all eligible members cooperating with the Fund. That being said, he could go along with conveying to the authorities and donors the Fund's readiness to show flexibility on the matter of special charges, in view of the current critical phase of Zambia's negotiations with the international donor community.

Mrs. Krosby remarked that her chair could accept the suggestion to convey to the authorities and donors the Board's intention to show flexibility with respect to special charges in the context of its forthcoming review of that issue.

Mr. Nakagawa said that while he had some concern about the recent tendency to convey subtle issues in Board discussions through letters from the Managing Director to member countries, he could support such an approach, as a compromise, in the case of Zambia.

The staff representative from the African Department remarked that the proposal to communicate the Board's intention with respect to special charges could be useful. In the staff's discussions with donors, the question of special charges was more symbolic than the amounts falling due in any particular period: Zambia was accruing special charges at a rate of about $6 million a quarter, while donors were being asked to put up about $400 million in balance of payments assistance, apart from financing for maize imports. It would be counterproductive if the Fund gave a signal that it was not willing to look at special charges in the light of efforts by Zambia and donors.

It should be noted that the middlemen were among the most adversely affected by the maize meal price increases, because for many consumers, the price of maize had been higher than the official price prior to the adjustments, the staff representative observed. Traders had in the past been making large profits. Moreover, maize prices had actually been reduced in the 18 months prior to the recent increases, while prices and wages had risen by about 150 percent.

With respect to revenues, it should be noted that a loss of 2 1/2 percent of GDP was attributable to the fall in copper tax revenues, the staff representative from the African Department remarked. The staff would provide information regarding other budgetary issues on a bilateral basis. As to Directors' comments on the need to act rapidly on budgetary measures, it should be noted that the 1992 budget had already been introduced and that most budgetary measures were already in place.

Mr. Mwananshiku stated that he wished to thank Directors for their supportive comments, which he would faithfully convey to his Zambian authorities. He was the first to agree that Zambia's performance in recent years had not been satisfactory, as the experience in 1991 illustrated. It had been expected that following the elections, the program that had been earlier agreed with the Fund would proceed. Instead, the multiparty election--which was the first substantial election in Zambia for a long time--had led to the disruption of the adjustment process, and the program had regrettably gone off track. Subsequently, a new Government had been installed and had quickly invited the Fund to send a staff mission to Lusaka. The authorities' enthusiasm for the adjustment program was very strong, as shown by the actions that they had taken in a period of only three months. As one Director had observed, in its discussions with the authorities, the staff had had to discourage the Government from moving forward too quickly in some areas. The authorities were committed to adjustment, they understood the challenge before them, and they recognized the need to put forward a new image in order to garner the support of not only the international community, but, even more important, of the Zambian people, who were aware that their standard of living was falling significantly. The new Government, therefore, had a duty to move forward and to take the required measures. Moreover, the Zambian people themselves had been encouraging the Government to do whatever was needed to restore economic growth. For an economy dependent on one major export commodity, that formidable task would require enormous effort on the part of the country as well as the support of the international community.

In that context, his Zambian authorities shared the view of some Executive Directors that special charges represented an additional burden for a country attempting to improve its economic situation and meet its obligations to the Fund, Mr. Mwananshiku observed. They were therefore interested in the possibility that the Fund might consider eliminating special charges as they moved forward, as an indication of its encouragement and support. He recognized that most Directors did not favor taking a decision in that respect at the current meeting, but he hoped that the Board would come back to the issue of special charges at a later stage.

It should be noted that in the southern African region, the critical period for growing maize was January, particularly the first two weeks, Mr. Mwananshiku commented. If there was no rain during those crucial weeks, the crop would be lost. That situation pertained in Zambia, Zimbabwe, Namibia, Botswana, and even South Africa: for the first time in many years, there were no stocks of maize in the entire region. Normally, the region was a surplus food supplier, but low rainfall in 1991, combined with the recent drought, had produced a critical food situation. In the previous week, the Government had carried out a country-wide survey to assess the situation, and following that survey, the new President had declared a state of emergency in the areas affected. The difficult situation in Zambia was mirrored in neighboring countries. All countries in the region were therefore looking to the international community for its assistance in meeting an extraordinary situation.

The Chairman remarked that the Executive Board was mindful and appreciative of the recent efforts of the Government of Zambia. It was, however, bound by the existing decisions with respect to special charges as well as by the principle of uniformity of treatment of all members. Several Directors had expressed the intention, in the context of the Board's review of the system of special charges in April, to consider modifying the April 1991 decision. In that light, the Fund could, in the meantime, prudently let it be known to donors and to the Zambian authorities that the Board had shown a readiness to modify the April 1991 decision in due time, provided that donors continued to show their strong support for the continued implementation of Zambia's program. He would instruct the staff to take that line when attending the meetings of donors, which he himself would adopt in communicating the outcome of the Board discussion to the Zambian authorities.

The Executive Board took the following decision:

1. The Fund has reviewed further the matter of Zambia's overdue financial obligations to the Fund in light of the facts and developments described in EBS/92/25 (2/12/92).

2. The Fund welcomes the adoption by Zambia of recent measures in the context of the formulation and implementation of a macroeconomic program for 1992. The Fund calls on external donors and creditors to augment flows of grants and concessional lending in support of Zambia's adjustment efforts on a timely basis.

3. The Fund notes the recent payments by Zambia and acquisition of SDRs to meet forthcoming obligations to the Fund. The Fund regrets, however, the continued existence of Zambia's arrears to the Fund, which places a financial burden upon other members and reduces Fund resources needed to help others. The Fund stresses that full and prompt settlement of these arrears should be given the highest priority.

4. The Fund will review the matter of Zambia's overdue financial obligations to the Fund again at the time of the Executive Board's further consideration of Zambia's rights accumulation program or within six months of the date of this decision, whichever is earlier, in light of the actions taken by Zambia in the meantime toward settlement of its arrears to the Fund and the formulation and implementation of an appropriate economic adjustment program.

Decision No. 9928-(92/19), adopted
February 19, 1992

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/18 (2/14/92) and EBM/92/19 (2/19/92).

5. ACCESS TO FUND ARCHIVES

The Executive Board approves the proposal relating to the use of material in the Fund archives as set forth in EBD/92/25 (2/11/92).

Adopted February 14, 1992

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/92/31 (2/14/92), by an Advisor to Executive Director as set forth in EBAP/92/31 (2/14/92), and by an Assistant to Executive Director as set forth in EBAP/92/32 (2/14/92) is approved.

APPROVED: September 2, 1992

LEO VAN HOUTVEN
Secretary