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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/6

3:00 p.m., January 18, 1989

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	C. Enoch
	Zhang Z.
	A. Rieffel, Temporary
J. de Groote	J. Prader
	L. Hubloue, Temporary
E. T. El Kogali	
	R. J. Lombardo
	R. Marino, Temporary
M. Finaish	
M. R. Ghasimi	O. Kabbaj
G. Grosche	B. Goos
	T. T. Do, Temporary
	A. Vasudevan, Temporary
A. Kafka	
	D. McCormack
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
J. Ovi	M. Fogelholm
	D. Marcel
G. A. Posthumus	
C. R. Rye	C.-Y. Lim
	S. Yoshikuni
	N. Adachi, Temporary
	T. Morita, Temporary
	S. Appetiti, Temporary

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present
IBRD: N. Gorjestani, B. Tuncer, Africa Regional Office. Administration Department: G. F. Rea, Director; H. J. O. Struckmeyer, Deputy Director; P. K. Craig, N. S. Jackson, P. J. McClellan, H. Wiesner, L. A. Wolfe. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director; N. Abu-Zobaa, D. T. S. Ballali, C. Enweze, C. D. Pham, G. B. Taplin, E. van der Mensbrugghe. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; A. Basu, B. Christensen, J. H. Felman. Legal Department: P. L. Francotte, J. W. Head, A. O. Liuksila. Treasurer's Department: F. G. Laske, Treasurer; D. Williams, Deputy Treasurer; T. Leddy, Deputy Treasurer; M. P. Blackwell, J. E. Blalock, P. J. Bradley, P. S. Ross. Special Advisor to the Managing Director: A. K. Sengupta. Special Advisor to the Deputy Managing Director: W. A. Beveridge. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. B. Chatah, M. Pétursson, B. A. Sarr, N. Toé, R. Wenzel, J. E. Zeas. Assistants to Executive Directors: A. A. Badi, E. C. Demaestri, S. K. Fayyad, B. R. Fuleihan, J. Gold, C. L. Haynes, C. J. Jarvis, K.-H. Kleine, C. Y. Legg, V. K. Malhotra, N. Morshed, W. K. Parmena, L. M. Piantini, S. Rouai, C. Schioppa, J.-P. Schoder, G. Serre, M. J. Shaffrey.

1. BUDGETARY OUTLOOK FOR FY 1990

The Executive Directors, meeting in restricted session, continued from the previous meeting (EBM/89/5, 1/18/89) their consideration of a memorandum from the Managing Director on the budgetary outlook for financial year 1990 (EBAP/89/10, 1/11/89).

2. ZAIRE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1

The Executive Directors considered a staff paper on the review of Decision No. 8996-(88/153) G/TR on the Managing Director's complaint under Rule K-1 relating to Zaïre's overdue financial obligations in the General Department (EBS/89/1, 1/6/89).

The staff representative from the African Department stated that the Fund had received two payments from Zaïre over the past few days totaling about SDR 10.2 million. That amount had covered the two repurchases and the semiannual charges in the General Resources Account that had fallen due in January to the current date, and had also eliminated the arrears with respect to interest on the funds made available under the structural adjustment facility. Owing to the SDR-U.S. dollar rate which had been applicable to the payment received, the payment had fallen short of covering the full amount of special charges to the General Resources Account by about SDR 9,000.

The Fund's resident representative in Kinshasa had informed the staff that a number of policy actions had been taken over the previous several days, the staff representative noted. On January 11, the exchange rate had been depreciated by about 9 percent, which had brought the cumulative depreciation since October to 46 percent, and the lending rates of the Bank of Zaïre were increased by 10 percentage points, to 45-49 percent. The authorities had also issued decrees effecting increases in a number of tax rates as of January 16. Those measures were in line with the understandings that had been reached with the staff mission of December 1988.

Mr. Mawakani stated that he wished to confirm the information provided by the staff representative from the African Department. Also, as had been indicated in the staff paper, the Zaïrian authorities were committed to honoring the payments coming due in January, February, and March 1989. In addition to the implementation of the policy measures that had been agreed with the Fund mission to Kinshasa in December 1988, his authorities had decided further to strengthen control of public expenditures through a unification of the centers for payments orders, placing them under the sole responsibility of the Prime Minister. The Zaïrian authorities hoped that those prior actions would pave the way for further discussions, leading to a comprehensive adjustment program that would merit the Fund's support.

Mr. de Groote stated that he supported the proposed decision, in which a review of the situation of Zaïre within three months was prescribed. Such a time period was entirely in conformity with the procedure followed in cases of countries in a situation similar to that of Zaïre.

Zaïre had made a serious effort at reimbursing the Fund the amount of overdue payments, thanks to the country's increased level of reserves, Mr. de Groote observed, and it appeared that negotiations with the Fund were proceeding satisfactorily. A number of important measures had already been taken, and additional measures would be taken, as the staff representative from the African Department had related. Also, he understood that the essential elements of an agreement with the Fund would soon be in place. At that time, his authorities would consider whatever measures might be needed to assist Zaïre in settling its remaining arrears to the Fund. The full involvement in the process of implementing a Fund-supported program for Zaïre of those friendly countries which had continued to show their willingness to provide assistance in the past would clearly be important.

Mr. Marcel stated that his chair welcomed the latest payments made by Zaïre. Mr. Mawakani's statement had conveyed the impression that some significant developments had taken place recently in Zaïre. However, it was difficult to assess clearly the economic situation, as the most recent data on economic performance was worrisome. Although some progress had been made in certain areas, such as the adjustment to the exchange rate and fiscal improvement measures, the rate of inflation had continued to increase, and the monetary and budgetary positions and the balance of payments had deteriorated.

His authorities strongly encouraged the pursuit of a dialogue between the Fund and Zaïre, Mr. Marcel continued, and welcomed the emphasis that had been placed on budgetary tools to reverse the downward trend in the relationship of revenue to GDP, and to achieve a major cutback in the monetary financing of the deficit. He urged the Zaïrian authorities to seize the opportunity of the upcoming staff mission to conclude an appropriate policy package which could serve as the foundation for a comprehensive and strong program of adjustment.

The staff paper demonstrated that, had a better control of imports in 1988 been achieved, a significant reduction in Zaïre's outstanding debt service payments, as well as its arrears to the Fund, could have been effected, Mr. Marcel observed. His authorities had noted that the Zaïrian authorities intended to clear the overdues that would accumulate in the forthcoming period through a so-called special operation, about which he would appreciate more information. That would allow his authorities to consider objectively whether progress was being made with respect to Zaïre's overdue financial obligations to the Fund, and to assess more accurately the willingness of the Zaïrian authorities to move ahead. His chair could support the proposed decision, bearing those considerations in mind.

Mr. Goos stated that he welcomed the fact that Zaïre appeared willing to normalize its relations with the Fund, and that he was greatly encouraged by the ongoing dialogue between the staff and the authorities, as well as by the recent payments Zaïre had made to settle its overdue financial obligations to the Fund. The repayment of overdue charges appeared to reflect the authorities' awareness of the heavy financial burden which the arrears placed on the Fund itself, and on the Fund's creditors and debtors. Encouraging as those developments were, the concern of his authorities about the remaining arrears was not allayed. He therefore urged the authorities to repay promptly all remaining arrears, as other Directors had also suggested.

He welcomed the detailed presentation of the balance of payments indicators that had been made in the staff paper, Mr. Goos continued, although he believed that the information that could be derived from them might easily be misinterpreted. In any case, he agreed that the balance of payments indicators provided an insight into Zaïre's external situation. They also heightened the concerns about Zaïre's overdue obligations in the previous year, because Zaïre's external situation was seen to have improved substantially that year. His authorities had reservations about applying the concept of ability or inability to pay as an indicator of the kind of reaction the Fund should have in particular cases of overdues--which he took to be the reason behind the detailed presentation of balance of payments indicators in the paper. The balance of payments indicators were actually of little help in that regard in any case, because they only reflected the financing constraints that stemmed from the type of inadequate domestic policies which were largely responsible for the emergence of arrears in the first place.

The information that had been provided in Table 1 of the staff paper on payments indicators, particularly that relating to the ability of Zaïre to generate foreign exchange, appeared to be somewhat misleading, Mr. Goos observed, because a country's total resources related not only to the amount of exports and other variables related to the current account position, but to the capital account as well. To his mind, a better indicator of the availability of resources was information relating to the uses of foreign exchange. That information, which had been provided in Item 3 in Table 1, showed the total of foreign exchange expenditures, to which changes in gross international reserves would of course need to be added. Even with a more accurate picture of total available resources, such a measurement alone would not take into account the ability of a country to greatly augment its foreign exchange receipts through the pursuit of more appropriate policies.

The proposed decision was appropriate under the circumstances, and he could support it, Mr. Goos concluded.

Mr. Rye stated that the stance of the Zaïrian authorities appeared to have undergone a dramatic transformation. He welcomed the new conciliatory and constructive tone of official public statements by senior members of the Government, although he was left wondering about the motivation for their earlier belligerent attitude. What was needed at present was real evidence of a more committed approach to policy reform, of which the measures the staff had referred to were but a first step. The positive signals which were emanating from Kinshasa would go some way toward meeting the minimum requirements of cooperation that his chair had suggested when the Board last discussed Zaïre's situation in October 1988 (EBM/88/152 and EBM/88/153, 10/12/88).

In accordance with Directors' requests, the staff had included in the staff paper a wide range of payments indicators, Mr. Rye noted, on which some Directors had placed great store in the hope of throwing more light on the question of inability versus unwillingness to pay. Like Mr. Goos, he had serious reservations about that concept. In the case of Zaïre, the full year figures for 1988 suggested, on the one hand, that Zaïre had not discriminated against the Fund in servicing its external debt; for the year as a whole, payments made to the Fund had constituted 58.3 percent of total debt payments made--substantially higher than the share of Fund obligations in Zaïre's total debt service obligations, of 29.1 percent. Moreover, Zaïre's arrears to the Fund of SDR 101.2 million needed to be seen in the context of an increase in total external arrears of SDR 563 million, while gross international reserves had increased only modestly, by SDR 26.4 million, to SDR 294.5 million--of which, according to the staff, much was committed in one way or another. On the other hand, it was significant that the increase of approximately SDR 300 million in current account receipts, which had largely reflected a sharp improvement in the terms of trade, had been used primarily to fund an increase in imports--of which not all could be described as essential, to judge from anecdotal reports. That could only be described as a wasted opportunity.

However, none of the data that had been presented had explained the hiatus in payments to the Fund between July and September 1988, Mr. Rye went on. When the intra-year pattern of payments was examined against the pattern of Fund obligations, the suspicion that the authorities had deliberately chosen to suspend repayments to the Fund in the third quarter of the year was difficult to avoid. A clearer picture of the intra-year pattern of other foreign exchange obligations would have thrown more light on that question.

A demonstration of the Zaïrian authorities' willingness to come to grips with the major economic problems that confronted the country would be of the utmost importance, Mr. Rye concluded. Given the gross deterioration in the fiscal position which had occurred in 1988, the design of an appropriate budget for 1989 would be a major first step in that direction. He had hoped that Mr. de Groote would be able to throw some light on what he took to be a serious rift that had emerged between Zaïre and Belgium, which had culminated in Belgium's decision to stop future development aid to Zaïre. If that development were confirmed, it would be a very serious matter. He supported the proposed decision.

The Chairman stated that, based on Mr. de Groote's comments, it had been his impression that Belgium was continuing to show its willingness to find a solution to the problems which had arisen, thereby contributing to the overall resolution of Zaïre's external difficulties.

Mr. Hubloue stated that his authorities remained ready to support Zaïre in the context of the ongoing discussions between the Zaïrian authorities and Belgium.

Mr. Marino stated that he welcomed the recent payments Zaïre had made to the Fund, and the authorities' intention to settle on their due dates Zaïre's obligations falling due to the Fund in January and February 1989. Although Zaïre had outlined a strategy to settle fully its outstanding arrears to the Fund by late February or March 1989, he was concerned by the large and growing imbalances in Zaïre's economy. The persistence of a large fiscal and external deficit might impair further Zaïre's capacity to meet its financial obligations. He thus urged the authorities to clear promptly their arrears to the Fund, and to design and implement the required economic and financial reforms.

In the context of the collaborative approach to the settlement of arrears to the Fund, Mr. Marino continued, he encouraged the authorities to take the necessary first steps, so that the support of the Fund and of the international financial community in general could be resumed. He was happy to learn from Mr. Mawakani's comments that the authorities were already taking some necessary actions. He supported the proposed decision.

Mr. Enoch stated that he welcomed the staff paper, which represented an imaginative start to the process of developing a framework of indicators to assist the Board in judging the degree of cooperation of overdue members with the Fund.

The key tests of cooperation with respect to a member in arrears were policy and payments performance, Mr. Enoch continued. The former indicated the adequacy of adjustment efforts; the latter, the extent to which payments to the Fund were regular and commensurate with the member's capacity to pay. Since the Board's last review of Zaïre's overdue financial obligations in October 1988, there had been a significant improvement vis-à-vis Zaïre on both those counts. The authorities had made and honored a commitment to contain the level of arrears to the Fund, as well as to settle their overdue obligations by the end of February or early March 1989. The information which had been provided by the staff representative from the African Department had also been welcome in that regard. Moreover, policy discussions with the staff had resumed, and although much remained to be done, the authorities were moving in the direction of an adjustment program that could be supported by the Fund following the settlement of Zaïre's arrears.

Zaïre's arrears had stabilized at a critical moment, Mr. Enoch observed. The stock of outstanding arrears was just over SDR 100 million, an amount that was apparently within the capacity of the country to clear. However, the further payments that would fall due in 1989 of approximately

SDR 200 million needed to be borne in mind. Therefore, if Zaïre were to fail to keep current in its future financial obligations and to settle its arrears by early March, the situation could become much more difficult to resolve, and another case of protracted arrears could develop. Action by late February or early March was consequently a matter of some importance. Reference in the proposed decision to a further review within three months, and to the possibility of further steps at that time, was therefore entirely appropriate. Hopefully, it would not be necessary to conduct the review at all.

If the present difficult relations between Belgium and Zaïre did not lead to a more permanent and general breakdown in relations with the international financial community, a Fund-supported program might be contemplated, Mr. Enoch continued, and it would seem desirable to issue and discuss as soon as possible an updated policy framework paper--under which the second annual arrangement under the structural adjustment facility would be framed. He would prefer that the paper be issued well in advance of the request for an arrangement under the structural adjustment facility or for the use of other Fund resources. It was important for the Board to have an input at the earliest opportunity, particularly in those cases in which a hiatus had occurred in the adjustment effort, and in which new Fund-supported programs were likely to be used to replace bridging loans to clear arrears.

The staff had made a helpful start on designing indicators for the determination of the inability versus the unwillingness of countries to repay the Fund, Mr. Enoch went on. However, he would suggest that a breakdown of the stock of debt and arrears would be a useful standard feature of such an analysis. That information would be necessary to detect discrimination against the Fund. Also, future projections would have been useful, such as estimates for 1989, for example. A breakdown of the components of the reserves might also be sensible, at least so as to distinguish gold holdings, how they had been valued, and whether they had already been pledged, if that were possible. In the longer run, the indicators might evolve into a cash flow table, to ensure comprehensiveness and consistency.

As the Board would be discussing the general issue of the treatment of arrears in the coming months, he wished only to make a few preliminary observations about it, Mr. Enoch continued. The lengthening of the time period between reviews of members following the declaration of their ineligibility to use the Fund's general resources should not send signals to members in arrears that the Board was any less concerned about arrears. Accordingly, the lengthening should be seen as part of a general restructuring of the Board's review procedures, in which informal briefings--particularly when there had been important developments, or after the return of a Fund mission from the member--extended the surveillance function of the review into a more ongoing, as well as a more candid, process. The six-monthly reviews of specific countries would then be an opportunity for the Board to bring its position more formally up to date.

The Fund should also begin to send the appropriate signals to those members that had just entered, or were about to enter, arrears, Mr. Enoch went on, by making use of special ad hoc meetings to discuss major developments at an early stage. Finally, the six-monthly review of specific countries in arrears might be held on two dates in the year, with the six-monthly report on arrears in general falling in between. The Board's work on arrears might be evened out in that way, and perhaps what was more important, the six-monthly report might then be used as the basis for reports on arrears to the spring meetings of the Interim Committee, as well as to the Annual Meetings. The need to schedule two sets of closely related discussions within a short time, as had occurred in September 1988, would thus be eliminated. He supported the proposed decision.

Mr. Al-Assaf stated that he was pleased to note that Zaïre was in the process of solving the technical problems relating to the settlement of its arrears to the Fund. He welcomed the two payments Zaïre had made to the Fund recently, as well as the assurances put forward by Mr. Mawakani concerning the future payment when due of forthcoming obligations. He looked forward to the full settlement of Zaïre's arrears to the Fund.

The indicators which the staff had provided in the paper so as better to judge the unwillingness versus the inability of a country to repay the Fund constituted a helpful source of information, but they did not suggest that the country's underlying policies should be ignored in making such a judgment, Mr. Al-Assaf commented. He supported the proposed decision.

Mr. Rieffel made the following statement:

> There have been two very positive developments since the Board's last review of Zaïre's overdue financial obligations. First, Zaïre has made substantial payments to the Fund. It is current in the SDR Department and to the Trust Fund, is current on charges, and has resumed meeting payments as they fall due. Nevertheless, we share the concerns expressed by other Directors about Zaïre's remaining overdue obligations.
>
> Second, the authorities in Zaïre have held serious policy discussions with the staff, and appear anxious to conclude an agreement with the Fund within the next month on a program that could be supported by Fund financing. In addition, Zaïre has undertaken some important economic reforms since the beginning of the year, and is clearly demonstrating a willingness to cooperate with the Fund.
>
> My authorities very much welcome these developments, and they are actively considering effective ways of supporting with bilateral assistance a strong program of macroeconomic reform and structural adjustment.
>
> We assume that Zaïre will agree on a program for 1989 that fully meets the criteria for financing under a stand-by

arrangement and under the structural adjustment facility, including appropriate prior actions. Consequently, we are not sure it is necessary in this case to have a separate Board discussion of a policy framework paper.

Nevertheless, Zaïre's record of implementing needed reforms is not a strong one. Therefore, it may be appropriate for the staff mission to provide the Board with an informal written report shortly after returning from its next visit to Kinshasa, perhaps along the lines of the appendix to the paper recently issued on Somalia's overdue obligations (EBS/89/3, 1/11/89). Such a paper would allow the Board to ask questions about the program before considering Zaïre's request for the use of Fund resources.

I would also like to note the apparent support in the Board for the commitment of Fund resources to Zaïre once it has formulated a strong economic program, implemented appropriate prior actions, and cleared its arrears to the Fund. We believe that the Fund should be prepared to commit its resources to other members that have accumulated arrears when they have taken comparable actions.

We welcome the additional information provided in the staff paper bearing on Zaïre's ability to pay the Fund, but we feel that further thought should be given to the kind of information needed to help the Board make such an assessment.

We support the proposed decision, and we ask Mr. Mawakani to convey to his authorities our hope that a foundation for strong and sustainable growth will be established in 1989.

The Chairman remarked that he was certain that Mr. Mawakani would also convey to the Zaïrian authorities the positive message put forth by the Fund's major shareholders about the possibility of strong bilateral support for an appropriate program.

Mr. Adachi stated that he wished to join other Executive Directors in welcoming Zaïre's recent payments to the Fund. His authorities had been encouraged by the recent policy developments which Mr. Mawakani had explained, and by the intention of the authorities to formulate a comprehensive adjustment program. However, the staff paper raised some serious concerns.

First, with respect to the ability of Zaïre to pay the Fund, the indicators showed that while current account receipts had increased by 18 percent from 1987 to 1988, the debt service payments that Zaïre had made to the Fund in the same period had declined by 28 percent, compared with an overall decline in debt service payments of 24 percent in the same period. That left a rather uncomfortable impression. Also, Zaïre's repayments to the Fund in 1988 accounted for only 6.9 percent of current account receipts, representing a 4.4 percent decline from 1987. Moreover, on the basis of information that his authorities had received from their representative in Zaïre, there were some doubts about the accuracy of the statistics provided to the staff. He would appreciate the staff's comments on that issue. He concurred with Mr. Enoch about the need to break down the components of reserves in the accounts statistics.

Second, his authorities had a great deal of difficulty in endorsing Zaïre's strategy for repaying the Fund, Mr. Adachi continued. The authorities were intending to seek financing which would be repaid in the context of the use of Fund resources, following clearance of Zaïre's arrears to the Fund. Such a strategy risked a moral hazard, in the view of his chair. Such a financing arrangement would send other member countries the wrong signal that a country in arrears to the Fund might receive preferential treatment from potential creditors and donors. Also, use of resources under the structural adjustment facility to pay for such financing, either explicitly or implicitly, would represent a transfer of risk from the General Resources Account to the ESAF Trust, in which repayments of resources used under the structural adjustment facility would eventually be placed. Moreover, his authorities were not in favor of using resources under the structural adjustment facility for financial restructuring. He therefore urged the Zaïrian authorities to implement a strategy to repay all Fund arrears with Zaïre's own resources.

It was clear that Zaïre's credibility was at a critical stage, Mr. Adachi concluded. It would be essential for Zaïre to give the Fund greater confidence about its commitment to adjustment before seeking approval for further Fund arrangements. He very much welcomed recent developments, and encouraged the authorities to intensify their efforts. He supported the proposed decision.

Mr. Fogelholm stated that he joined other Directors in welcoming the latest payments Zaïre had made to the Fund. He was also pleased to note the progress which had been made in the discussions between the Zaïrian authorities and the Fund on adjustment policies. Furthermore, he was encouraged by the recent policy measures which had been undertaken, as the staff had described. A comprehensive adjustment program would clearly be required to revive economic growth, while at the same time increasing stability in the domestic and external sectors.

Like Mr. Adachi, Mr. Fogelholm went on, he also had some questions regarding the elimination of arrears and the authorities' strategy. In particular, he would be interested in knowing the size of the necessary bridge loan, how much of it would be drawn from Zaïre's own reserves, and what the size of likely future calls on the Fund's resources would be. Also, it would be helpful if the staff could inform the Board of the type of program that was currently contemplated, and how it would be financed.

He had been generally satisfied with the staff's presentation of Zaïre's overdue obligations in tabular form, Mr. Fogelholm concluded, and he did not view those tables as a threatening development. The tables would be helpful for the Board in assessing a country's overall position, regardless of whether or not the information in them could be used precisely for the purpose of judging the unwillingness versus the inability of a country to repay. He supported the proposed decision.

The staff representative from the African Department stated that the special operation to which the Zaïrian authorities had referred was the bridging loan for the amount that would be needed to clear arrears, namely, about SDR 100 million. The authorities intended to meet, and indeed had met so far, their current and forthcoming obligations as they fell due. The distinction between the use of the bridge loan to repay arrears and use of reserves was somewhat blurred.

Because Zaïre was covered by a three-year arrangement under the structural adjustment facility, the staff representative went on, the program that was being envisaged was the second annual arrangement under that facility. The authorities were also requesting a parallel stand-by arrangement, which was being given active but careful consideration by the staff.

The staff had been working on the assumption that any arrangement for Zaïre would follow a one-stage, rather than a two-stage, approach, the staff representative explained. Separation of the discussion on a policy framework paper from the discussion of the second annual arrangement under the structural adjustment facility was difficult in some respects, and the authorities and the staff had agreed to consider them as one. If major obstacles toward agreement on the formulation of a program arose, examination of a policy framework paper alone might of course be in order, but given the progress that had recently been made in Zaïre's arrears payments, that did not appear to be necessary. Moreover, institution of a two-stage procedure--along the lines of Mr. Enoch's suggestion--might risk a delay in the settlement of Zaïre's arrears. The staff could report to the Board informally as to the outcome of the staff's next round of discussions with the authorities, along the lines of Mr. Rieffel's suggestion, if the Board so wished.

The statistics which the staff had presented for 1988 were estimates and were not final figures, as Mr. Adachi had surmised, the staff representative concluded. As with many developing countries, the staff had found it necessary to deal with deficiencies in the data base in making those estimates, which would be examined carefully, and updated and revised in light of more recent and more accurate information when it became available.

Mr. Adachi commented that the staff representative from the African Department had presented a good explanation of the data. Although he could understand the staff representative's point about the difficulty of making a distinction between bridge financing and nonbridge financing, he wondered whether the staff believed that Zaïre would be able to repay all of its arrears without relying on bridge financing.

The staff representative from the African Department replied that Zaïre would be unable to clear all of its arrears in the near future without relying on bridge financing.

Responding to a question from Mr. Posthumus, the staff representative stated that although there were no firm indications as to which party would be providing the bridge financing, the authorities were considering a number of possibilities. Zaïre had maintained over a long period financial relations with a number of commercial banks which the country might seek out.

Mr. Mawakani commented that if Zaïre were able to settle all of its arrears without a bridge loan, it would do so immediately. Unfortunately, Zaïre did not have such a capability, which was why the authorities had felt it necessary to describe to the staff their strategy for settling arrears. The question of the source of the bridge loan was currently being explored, and would be resolved in the near future. The authorities had indicated that Zaïre would be in a position to settle all of its arrears before the end of March 1989, and thus would re-establish normal relations with the Fund.

He did not agree to the suggestion that the Board hold a discussion on Zaïre before the formulation of a policy framework paper, Mr. Mawakani continued. Consideration of the program the authorities were working on with the staff would then be delayed. Furthermore, the Zaïrian authorities had taken prior actions, as discussed with the Fund, and had shown their willingness to cooperate with the Fund. Finally, Zaïre had repaid far more, in absolute terms, than many other Fund members in arrears, and was committed to meeting shortly forthcoming financial obligations to the Fund. It would be inappropriate to request the country to do yet more, under the circumstances.

Mr. Enoch noted that his suggestion had not been intended to delay the Board's discussion of the program, but to accelerate the initial discussion of the policy framework paper as the overall negotiations continued. In the light of the comments and suggestions of the staff representative from the African Department, as well as of Mr. Mawakani, he could fully support Mr. Rieffel's suggestion that the status of progress in the negotiations be covered in an informal meeting.

Mr. Mawakani remarked that an informal meeting of the Board would be acceptable to his authorities. However, a formal Board meeting on a staff report outlining the progress of the negotiations would be interpreted by the Zaïrian authorities as a negative sign from the Fund.

Mr. Rieffel said that his authorities were interested in the one-stage approach that had been outlined by the staff representative from the African Department. His authorities were not interested in delaying matters.

The Chairman remarked that Executive Directors could rest assured that the staff and management would as usual carry out their responsibility for reaching agreements that were in the best interests of the Fund, taking care to preserve a positive momentum in the negotiations on the issues of the stand-by arrangement and settlement of arrears.

He had been impressed by the actions that had been taken by Zaïre, the Chairman commented, and every effort must be made to build on them. He was grateful to Mr. Mawakani for his contribution toward the success of the discussions. The Board would be kept informed of developments in the negotiations. The staff and the management would concentrate their energies on achieving the full settlement of Zaïre's arrears to the Fund before the end of March 1989, and on establishing an effective economic program for Zaïre that could be supported by a stand-by arrangement.

The Executive Board then took the following decision:

1. The Fund has reviewed Decision No. 8996-(88/153) G/TR, adopted October 12, 1988, in the light of the facts described in EBS/89/1 (1/6/89) pertaining to Zaïre's overdue financial obligations to the Fund.

2. The Fund welcomes the recent payments made by Zaïre. However, the Fund regrets the continuing nonobservance by Zaïre of its financial obligations to the Fund in the General Department and notes that further substantial obligations will fall due in the near future. The Fund urges Zaïre to make full and prompt settlement of the overdue financial obligations to the Fund, and stresses that settlement of these arrears should be given the highest priority.

3. The Fund notes the economic adjustment measures under consideration by Zaïre and urges the authorities to implement these measures as well as the other measures needed to constitute a comprehensive adjustment program as a matter of urgency. The Fund continues to stand ready to respond to the authorities in support of efforts to formulate and implement a comprehensive adjustment program.

4. The Fund shall review further Decision No. 8996-(88/153) G/TR within a period of three months from the date of this decision, if Zaïre has not become current in its financial obligations to the Fund by that time. At the time of that review the Fund will consider the appropriateness of further steps.

Decision No. 9061-(89/6), adopted
January 18, 1989

3. SOMALIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Somalia's overdue financial obligations to the Fund following the declaration of its ineligibility to use the Fund's general resources, effective May 6, 1988 (EBS/89/3, 1/11/89, and Correction 1, 1/17/89).

Mr. Finaish made the following statement:

I would not be speaking frankly if I did not express my concern about the relatively slow pace of progress toward resolving the problem of Somalia's arrears to the Fund. Speaking not only as a representative of Somalia but also as a member of the Board, I am afraid that we are losing valuable time; something which I believe we cannot afford in this case. There is no question that Somalia's economic and financial problems are enormous. However, over the last six or seven months the authorities have demonstrated, by word and deed, that they are willing--indeed eager--to cooperate with the Fund in resolving their arrears problem. It is true that in the past Somalia has been in and out of arrears to the Fund more than once; and one can, therefore, appreciate the Fund's position of wanting to be assured that a sound basis is laid for a permanent solution to this problem. However, when the member demonstrates in a strong manner its willingness and ability to take difficult policy decisions, as Somalia has done over the last six months, the Fund, together with Somalia's friends, should do whatever they can to move the process forward.

The appendix to the staff paper describes the substantial adjustment effort that was made in the second half of 1988. I will not go over all the policy measures that were implemented over that period, but it is important to fully appreciate the magnitude of adjustment which has taken place in a number of crucial policy areas.

For example, in the fiscal sector, in addition to achieving the revenue target, the authorities have been able to keep ordinary expenditures in the second half of 1988 at a significantly lower level than envisaged in the program. For the year as a whole, ordinary expenditures are estimated to have declined by about 26 percent in real terms compared with 1987. As a result of these measures, the overall deficit, excluding grants, was lower than envisaged in the authorities' program.

Reflecting this fiscal performance, and the authorities' strict credit policies, monetary developments in 1988 were broadly in line with program targets. It should be recalled that in August 1988 interest rates were raised substantially. The savings deposit rate was raised from 12 to 40 percent, the minimum lending rate from 15 to 50 percent, and the discount rate from 12 to 45 percent. I believe that it is important to keep in mind that interest rate policy is one area where more is not necessarily better. Excessively high rates are not costless, and indeed can be counterproductive not only in terms of output and investment, but also in terms of their impact on prices. In setting interest rates, it is therefore important that all the implications be taken into account, instead of focusing narrowly on short-term movements in the price level. This is particularly so when contractionary credit policies are being pursued. In this connection, it should be mentioned that with the exception of November, when an increase in inflation was recorded due to supply factors and administered price hikes, inflation has been on a downward trend in recent months. In December, the consumer price index is estimated to have actually fallen by 0.4 percent.

As far as the exchange rate is concerned, Directors are aware of the substantial depreciation of the official rate in mid-1988, and of the weekly adjustments that have been made since then on the basis of inflation differentials between Somalia and its trading partners. Unfortunately, however, the balance of payments performance was weaker than expected under the program. On the one hand, the decline in exports, associated to a large extent with the security situation in the northern part of the country, exceeded the authorities' expectation; moreover, the gross disbursements of official assistance declined by more than one third in 1988. On the other hand, in spite of the 27 percent decline in imports relative to 1987, the current account weakened further.

In the structural area, the authorities have taken a number of measures in line with their stated policy of liberalization and enhancing private sector involvement in the economy. In this connection, let me include the text of a decision adopted recently by the Central Committee of the Ruling Party, which I received a few days ago from the Governor for Somalia.

> The Central Committee has resolved that the national constitution be reviewed and adjusted to the present situation of the country. Among the most important articles to be amended are articles 41, 43 and 44, all of which apply to the economic structures and system of the country. The Central Committee's proposal is that these articles be amended in such a way to encourage the national economic development in general and in particular the economic initiative of the private sector and foreign investment in the country. In order to speed the national economic development, the Central Committee has resolved that sectors which had previously been tied legally to the state should now be open to private participation so as to

give birth to a healthy and constructively competitive economy that best serves the country, the most important of these sectors being:

- banks
- insurance
- shipping and port services
- trade in hides and skins
- trade in frankincense, myrrah and different kinds of gum
- import of medical and veterinary drug

The Central Committee also decided that some of the state owned economic agencies be reorganized, allowing private share of ownership where this is economically appropriate.

The Somali authorities are working closely with the World Bank, and also with the Fund, on specific structural reform measures. But it should be recognized that in countries like Somalia, the implementation of some structural measures has to take into account administrative and other constraints. Within these constraints, I believe the authorities are moving ahead and building on the significant liberalization that has already taken place.

Over the past six months, the authorities have done a great deal in terms of actual policy measures, and in trying to convince the international community of their commitment to the adjustment and reform process. Unfortunately, however, external support has not been as strong as it should have been. As I mentioned earlier, external assistance has, in fact, fallen sharply from its 1987 level.

In my view, the coming weeks will be crucial; and all the parties concerned should multiply their efforts to build on the adjustment momentum which the authorities have been able to achieve. As some Directors may be aware, the Governor of the Central Bank of Somalia and the Vice Minister of Finance will be visiting Washington toward the end of this month in order to iron out the remaining policy issues, and thus pave the way for a policy framework paper and an adjustment program which is endorsed and monitored by the Fund.

I do not want to enter into the details of the policy issues in question, but I believe it is important that all parties concerned adopt a pragmatic approach: an approach which is most likely to lead us to the desired objective. Clearly, a Fund-monitored program has to be a strong and credible one. But, I do not think it would be realistic to expect that a shadow program of a limited duration will correct all the imbalances in the Somali economy. This would not be realistic even if the program was supported by Fund resources.

We are hopeful, however, that the forthcoming discussions will be fruitful and will make it possible to apply the intensified collaborative approach which was endorsed by the Interim Committee last October.

A few weeks ago I visited Somalia and had extensive discussions with the authorities, including the President of the country. On the basis of those discussions I can assure the Board of the authorities' strong commitment to the cause of reform and adjustment on which they have embarked. I can also assure the Board that the authorities attach great importance to Somalia's relations with the Fund, and especially to the matter of Somalia's financial obligations to this institution. It is true that the payments made by Somalia in the recent period have been modest, but this has to be measured against the country's extremely difficult foreign exchange situation. Moreover, the limited debt service payments which Somalia has made, particularly to the World Bank, have to be understood in terms of their net cash flow implications, and not as available cash which the authorities could have used on the basis of an abstract order of priorities.

Finally, my discussions with the Somali authorities have again confirmed to me the legitimate concern of the authorities about the extent and timeliness of the external assistance which they could count on in support of their adjustment effort. In recent years, shortfalls and delays in external support have contributed a great deal to the interruptions in Somalia's adjustment programs. The experience of the past six months has not been a comforting one either. In my view, it would be crucial for the Fund in the period immediately ahead to intensify its contacts with Somalia's donors and creditors in order to formulate a financing plan which will ensure the sustainability of Somalia's adjustment efforts. In the process, it should be made clearer to the authorities that they will not be left alone in the middle of the difficult adjustment road which they are charting in cooperation with the Fund.

Mr. Appetiti made the following statement:

In the appendix to the staff paper, the staff reported on the progress Somalia made during the second half of 1988 in strengthening its economic adjustment, with a view toward setting the stage for the implementation of a strategy based on the intensified collaborative approach.

It is encouraging to note that the implementation of the fiscal and financial policies has been mostly in line with the program established by the Government. We take this progress as an important sign of the authorities' ability and intention to proceed in the right direction.

A flexible exchange rate policy has also been implemented as envisaged, allowing the Somali shilling to be adjusted weekly since last August. This is again a step in the right direction, and it is appreciated. However, the official exchange rate remains overvalued, as indicated by the ratio to the free market rate, and needs to be further corrected. We also regret the weaker than expected performance of the current account of the balance of payments in 1988, and the balance of payments as a whole, in spite of a considerable decline in imports when compared with 1987.

The Board could not--and did not--expect Somalia's economy to recover in six months; therefore, it does not come as a surprise to note that in spite of the progress made during the last six to seven months, Somalia's economy remains in a precarious situation, and much still needs to be done. We are all well aware of the economic and financial problems that Somalia is facing, and I wish to reassure Mr. Finaish that my authorities appreciate the efforts that the Somali Government has undertaken during the second half of 1988. However, at this juncture, it is particularly important that the authorities strengthen the momentum of adjustment by intensifying further their adjustment efforts, so as not to waste what has been achieved during the last six months of 1988.

We therefore encourage the authorities to persevere in this direction and, at the same time, continue their discussions with the Fund staff with the aim of reaching an agreement on a medium-term adjustment program. We believe that this is not only in the general interest of the country, but is also essential to the development of a strategy within the intensified collaborative approach to bring to an end the country's arrears to the Fund. In this regard, we noted Mr. Finaish's remarks about the visit of the Governor of the Central Bank of Somalia and the Vice Minister of Finance to Washington to pave the way for a policy framework paper and an adjustment program to be endorsed and monitored by the Fund.

Progress in the implementation of economic policies has not been accompanied by comparable progress on the arrears problem. It is with regret that we note that Somalia has made only small repayments to the Fund since the last review of its overdue financial obligations.

We therefore urge the authorities to give the settlement of obligations to the Fund the highest priority. We attach particular importance to arrears because the Fund is a cooperative institution, and members in arrears place a financial burden on other members, reducing at the same time the amount of resources that are available for lending. Furthermore, it is important at this juncture that the authorities strengthen the evidence of Somalia's intention to intensify its cooperation with the Fund, and send strong signals to the international community to that effect. I am glad to reassure Mr. Finaish and the Board that the Italian authorities are ready to cooperate with other major donors to help solve the problem of Somalia's arrears to the Fund within the framework of the intensified collaborative approach.

Finally, we consider that it would be useful to review further Somalia's overdue financial obligations to the Fund following the return of the Fund mission to Mogadiscio, provided that that takes place within the next four months. We support the proposed decision.

Mr. El Kogali stated that overdue obligations remained a serious problem, for which a satisfactory solution was yet to be found. Zaïre and Somalia were but the problems of the day, and in less than two weeks the Board would review the cases of three countries in his constituency--Zambia, Sierra Leone, and Liberia. The case of the member with the largest arrears of all--Sudan--would come up shortly, while it could be expected that many other countries would soon experience arrears problems. The arrears problem existed because of genuine difficulties, and the Fund's approach needed to take into consideration the realities prevailing in the affected African countries. Countries in arrears were experiencing exceptional hardships, both man made and God made, and the Fund's insistence that those countries clear their arrears, without trying to find a feasible way of doing so, would not resolve the problem. A common effort by the countries concerned, the Fund, and the donor community would be required if a lasting solution was to be found.

Somalia was an example of a case in which the collaboration of the Fund and the international community in support of the strong adjustment measures that the Somali authorities were contemplating could be expected to lead to a resolution of the problem, Mr. El Kogali concluded. He agreed with Mr. Finaish that the Fund should intensify its contacts with Somalia's creditors. He urged all other creditors to join together in mobilizing the needed resources, so as to ensure the sustainability of Somalia's adjustment effort and the clearance of its arrears.

Mr. Goos said that he welcomed Mr. Finaish's encouraging statement, and his assurances that the Somali authorities were committed to adjustment and to the normalization of relations with the Fund, in particular. While those commitments seemed to be borne out by the recent good performance under the program, there were still some unsatisfactory developments. Most notably, the balance of payments was weak, which clearly indicated that the adjustment efforts needed to be strengthened further in order to secure a viable position. A competitive exchange rate, remunerative interest rates, and further progress in fiscal adjustment and structural reform appeared to be of particular importance if the progress in adjustment that had been achieved so far was to be preserved and expanded.

Unfortunately, the strength of the authorities' efforts to clear Somalia's arrears to the Fund could not yet be confirmed, judging from some recent developments, Mr. Goos observed. There were worrisome indications of discrimination against the Fund in the recent record of Somalia's debt service payments. That was all the more regrettable given the catalytic role the Fund could play once the authorities cleared their arrears. Against that background, the urgent reminder in the proposed decision that the authorities needed to give the highest priority to the full and prompt settlement of Somalia's arrears to the Fund appeared highly appropriate.

On a more technical level, Mr. Goos continued, he had noted that the staff had omitted from the paper the usual review of the way the Board had treated comparable arrears cases. He wondered what the reasons were for that omission. He had always found those reviews helpful, and encouraged the staff to maintain the practice. Also, the point he had made in the case of Zaïre concerning the misleading character of the statistics relating to the ability of a country to generate foreign exchange, and the greater usefulness of the measure of total foreign exchange expenditures, would apply equally to the case of Somalia.

He hoped that the forthcoming staff mission and the upcoming visit of Somalia's Governor and Finance Minister to the Fund would help to remove the remaining obstacles to a satisfactory agreement, Mr. Goos concluded.

Mr. Enoch stated that he had commended the staff paper on Zaïre's overdue financial obligations to the Fund as a useful start to the process of developing a framework of indicators to assist the Board in judging the degree to which overdue members were cooperating with the Fund. The staff paper on Somalia took that process further, with an appendix that described the progress that had been made in implementing the agreed corrective measures during the second half of 1988. The appendix also provided a useful table on outstanding debt and arrears. The significantly augmented information in the review papers should provide the Board with better guidance on how to move forward on a case-by-case basis in dealing with the problems of members in arrears.

The staff paper showed that a welcome start had been made in steering Somalia back onto an appropriate adjustment path, Mr. Enoch commented. The authorities had begun to establish a credible track record. Given the serious difficulties facing the country, it was imperative that the authorities build on what had been accomplished so far. While the progress that had been made should not be understated, it was clear that much remained to be done. The exchange rate, for example, was a key area requiring attention. While a substantial depreciation of the rate had already been effected, as Mr. Finaish had pointed out, the rate was currently only being held constant in real effective terms, and the staff paper noted that a substantial degree of overvaluation persisted. Sustained economic recovery would require the restoration of lost competitiveness. Another priority was to ease some of the structural impediments to adjustment, and the present efforts to that end should be extended as soon as possible into a comprehensive program. He hoped that a policy framework paper could be agreed as a matter of urgency, as it would also be necessary to mobilize the exceptional external assistance that would be required to support a viable adjustment program, and to the eventual clearance of arrears to the Fund. The forthcoming visit to Washington of the Governor of the Central Bank and the Vice Minister of Finance would seem to be a good opportunity to resolve any remaining issues.

Another element in the process of restoring normal relations with the Fund should be a demonstration of the authorities' commitment by their resuming regular payments to the Fund commensurate with the member's capacity to pay, Mr. Enoch continued. Unfortunately, not much progress had been made on that front, as payments to the Fund of only SDR 0.4 million had been made. The data in the staff paper indicated that preferential treatment had been given to the World Bank--to which Somalia had avoided arrears--and to some bilateral creditors. About 29 percent of Somalia's total arrears were to the Fund, compared with under 11 percent of debt. The Fund had received only a very small proportion of Somalia's foreign exchange earnings--about 1.6 percent of export earnings, and 0.3 percent of current receipts. At the same time, Somalia had made a number of downpayments on a new wide-bodied aircraft. He therefore concurred with the staff that Somalia's payments effort had been only modest so far.

It was important that the authorities begin making regular payments to the Fund immediately, even if they were initially relatively modest compared with the level of outstanding arrears, Mr. Enoch stressed. The level of payments should then be accelerated rapidly as adjustment progressed, so that at least charges could be covered, the arrears problem contained, and the process of organizing a full settlement facilitated. The need for the Somali authorities to resume regular payments should be a principal message of the next Fund mission to Somalia. Perhaps the authorities would consider using part of the cash rebate of $5 million expected from the purchase of the aircraft from Airbus Industrie to make a payment to the Fund; such an action would be a significant gesture of the authorities' commitment. He supported the proposed decision.

Mr. Rieffel made the following statement:

We are encouraged by the progress made by Somalia in implementing appropriate policies since the Board's last review.

The need for policy reforms has been underscored by the sharp decline in export receipts that occurred in 1988.

We are disappointed, nevertheless, by Somalia's poor record of meeting its financial obligations to the Fund. Because of this record, we have difficulty in concluding that Somalia is cooperating fully with the Fund toward the goal of becoming current on its Fund obligations.

We appreciate the detailed information on the Government's policies provided in the appendix to the staff paper, and suggest that similar information be provided for the reviews following ineligibility in other cases in which major developments in the formulation or implementation of needed policy reforms have occurred since the Board had occasion to review the economic situation in depth.

We also appreciate the information provided by the staff on payment indicators, but find that this raw statistical information is of limited value in assessing a country's ability to pay. We would like to see more information provided about those creditors that are being paid, including an attempt to explain why they are being given preference over the Fund. These review papers could also try to identify steps that the authorities can take in the short term to increase the availability of foreign exchange.

We are pleased that Somali officials will be coming to Washington shortly, and we hope that the authorities will reach agreement with the staff on a policy framework paper and a strong program for 1989 that could justify exceptional financing from aid donors.

We note that at the informal meeting of the Board on Somalia last month, the staff outlined an approach to normalizing Somalia's relations with the Fund that would involve a one-year shadow program, during which funds would be placed in an escrow account to facilitate the clearance of arrears to the Fund at the end of 1989. I am not sure that this is the best approach in this case. If the staff is successful in reaching agreement on a policy framework paper and an adequate program for 1989, we believe that such questions should be left to a support group, which could be established to examine the broader question of funding the most suitable financing arrangements for normalizing relations with the Fund and other creditors and donors.

We support the proposed decision, with the understanding that the staff will brief the Board upon its return from its forthcoming visit to Somalia.

Mr. Rye stated that Somalia appeared to be a particularly illustrative example of a Fund member which had slipped very quickly from being unwilling to repay into being clearly unable to do so, although those distinctions were always more than a little arbitrary. On the basis of the data presented in Table 1 in the staff paper on payments indicators, it was difficult to see an early resolution of Somalia's arrears. Over the medium term, the crucial issue which underlay Somalia's precarious position was clearly external financing--on which point he could agree fully with Mr. Finaish. Perhaps the staff could present the future implications of the hiatus in external grant disbursements that had been experienced during the second half of 1988. The data left no doubt that Somalia had not treated the Fund as a preferred creditor, as Somalia was completely current in its payments to the World Bank, and had made some payments to other creditors. The recent tendency of members in arrears to discriminate in favor of the World Bank was a particularly worrying trend, especially if it were perceived, as he suspected, that the conditionality of World Bank loans was easier to bear.

In the Chairman's message to the authorities, Mr. Rye continued, the authorities should be reminded that their recognition of the Fund's preferred creditor status was an essential element in any strategy to cooperate with the Fund in a collaborative effort to clear arrears. By the first test of cooperation, namely, the commitment to a comprehensive and workable program of policy reform, the authorities had gone some way toward re-establishing their credibility. However, progress was needed on the exchange rate, the fiscal front, and probably also in the control of credit. The rate of progress on the reform of the public enterprises had also been clearly inadequate.

Despite the welcome further steps the Somali authorities had taken, and which Mr. Finaish had described, more would need to be done before the authorities could claim credibly that they had embarked on a program of adjustment that would assure external viability over the medium term, Mr. Rye concluded. Clearance of Somalia's arrears to the Fund would create the foundation upon which future progress toward that end could be built. He supported the proposed decision.

Mr. Marino stated that he welcomed the progress the Somali authorities had made in implementing the economic and financial policies that would enable them to undertake a comprehensive medium-term structural adjustment program monitored by the Fund. He agreed with the staff that the gains that had been made would have to be consolidated by intensifying the adjustment effort.

His chair considered that members in arrears should give the highest priority to the settlement of their overdue obligations to the Fund, Mr. Marino noted. Accordingly, he deeply regretted the fact that Somalia had made larger payments to other creditors than to the Fund since the declaration of Somalia's ineligibility to use the Fund's general resources. However, he understood Mr. Finaish's explanation of the sequence of events which had caused Somalia to take such a decision.

In accordance with the collaborative approach to the settlement of arrears to the Fund, Mr. Marino concluded, he urged the Somali authorities to make every effort to eliminate their arrears, and urged donor countries to resume their assistance to the country. He endorsed the proposed decision.

Mr. Morita stated that he welcomed the fact that the Somali Government had implemented the economic and financial policies in a broadly satisfactory way. That was a first step in the right direction, and reflected the Somali authorities' intention to cooperate with the Fund. However, the adjustment effort needed to be broadened and strengthened in some major areas on the fiscal side, and could be accelerated in other areas, such as the reform of the public enterprises.

He welcomed the authorities' commitment to further efforts, Mr. Morita concluded. He had noted that a token payment had been made by Somalia, but he had been a bit disappointed that the efforts for the full and prompt settlement of Somalia's overdue financial obligations to the Fund appeared modest. The proposed decision was thus highly appropriate. He supported the proposed decision.

Mr. Fogelholm asked whether the staff could make an assessment about the possibility of reaching a positive conclusion in addressing Somalia's overdue financial obligations in the forthcoming discussions with the authorities. He also wondered to what extent the civil unrest in the northern part of the country might affect the possibility of Somalia's maintaining a viable economic performance.

The staff representative from the African Department stated that the level of external grants Somalia had received in 1988 had been about 15 percent to 20 percent below what had been anticipated under Somalia's economic program. Reflecting this, the overall fiscal deficit, excluding grants, had been less than had been envisaged under the program, but the deficit had been greater than under the program when grants were included.

The staff had made considerable progress in its discussions on a policy framework paper with the Somali authorities at the time of the last mission in November 1988, the staff representative continued. One of the points on which the staff and the authorities could not agree, however, was the rate of exchange. The staff held that a faster adjustment of the exchange rate would be appropriate so as to narrow more quickly the gap between the official and free market rates. Also, the authorities had been slow in introducing some measures on the structural front that the staff had believed would be essential for encouraging exports, but the Central Committee of the Ruling Party had recently approved abolishing the state monopolies in several sectors and economic activities. Although the authorities had also expressed a desire to lower interest rates, given the improved inflation performance, the staff believed that more time would be needed to ensure that inflation was firmly in check before such a step could be contemplated. Agreement had also not been reached on the revenue measures in the 1989 fiscal budget. Overall, however, the staff believed that the chances were good that an agreement would be reached during the upcoming mission to Somalia.

The civil unrest in the northern part of the country had created considerable dislocations in many respects, the staff representative remarked. The port of Berbera, the main port of the Ogaden region, had been closed for some time, and although there were reports that some minor shipments had recently been made from Berbera it appeared that the port was still not fully operational. The cities in the north had suffered considerable damage, and their populations had resettled elsewhere--some in Ethiopia. It was likely that the eight northern branches of the commercial bank, which had substantial amounts of credit outstanding, would never be able to recover the money completely.

There was no question that Somalia's program would be affected by the civil unrest, the staff representative concluded, although the Government hoped that, through a reconciliation of the warring parties, the effects would not be as severe in 1989 as they had been in 1988. Nevertheless, the situation could not be considered a normal one at present.

The staff representative from the Treasurer's Department, responding to Mr. Goos's question about the lack of a table in the staff paper outlining the Board's actions in similar cases of arrears, explained that such information was generally included only when the member being reviewed had not yet been declared ineligible to use the Fund's general resources. In those reviews, the Board was often called upon to take substantive action, and the staff believed that comparative information would be a useful guide for the Board in those cases. As Somalia had already been declared ineligible, the present review, while expressing the Board's views and setting the timetable for the next review, did not require any substantive action by the Board.

In the last six-monthly report of overdue financial obligations to the Fund (EBS/88/243), the staff representative noted, the staff had included a new table presenting, for each member that had been declared ineligible, the dates the reviews had taken place, the periods of time determined until the subsequent reviews, the amount of outstanding arrears, and like information. Directors might wish to refer to that document.

Mr. Finaish stated that the case of Somalia was clearly a difficult one. Somalia had attempted honestly and with great effort to cooperate with the Fund, especially considering its unfavorable circumstances.

In each review of Somalia's overdue financial obligations to the Fund, Mr. Finaish continued, the Board had acknowledged the positive steps the Somali authorities had undertaken, and the fact that they were moving in the right direction. Notwithstanding those positive actions, however, the appropriate assurances from the other parties to Somalia's external problems--Somalia's creditors--was not forthcoming, and that, in his view, was at the heart of the problem. The Somali authorities needed to do more, but further positive steps would be impossible without parallel and commensurate support from the creditors. Mutual involvement of both creditor and debtor had to be considered as a prerequisite for the success of the collaborative approach.

The situation in the northern part of the country was beginning to stabilize, and reconstruction of certain areas had begun, Mr. Finaish stated. Exports had been seriously affected by the dislocations, but the situation appeared to be on the mend.

He had tried to explain the situation behind the authorities' decision to repay other creditors sooner than the Fund, Mr. Finaish concluded. It was clearly a difficult question, but use of the word "discrimination" to describe Somalia's action might be, in his view, somewhat harsh, especially given Somalia's circumstances.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Somalia's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/89/3 (1/11/89).

2. The Fund deeply regrets the continuing failure by Somalia to fulfill its financial obligations to the Fund, which are placing a financial burden upon other members and reducing Fund resources needed to help others. While welcoming the payments made by Somalia since the declaration of ineligibility, the Fund notes that they represent only a modest effort on the part of Somalia to meet its financial obligations to the Fund. The Fund urges Somalia to give highest priority to the full and prompt settlement of its arrears to the Fund and to take all necessary actions in this respect.

3. The Fund welcomes the economic measures implemented recently by Somalia as important steps in the right direction. The Fund urges the authorities to sustain and strengthen their adjustment efforts and to complete their discussions with the Fund staff on a medium-term adjustment framework to form the basis for development of an intensified collaborative approach to the resolution of the problem of Somalia's arrears to the Fund.

4. The Fund will shortly be discussing its policies on arrears to the Fund. It will review the matter of Somalia's overdue financial obligations to the Fund again within four months from the date of this decision in light of these

discussions and of actions taken by Somalia in the meantime to settle its arrears to the Fund and to formulate and begin implementing a comprehensive economic adjustment program.

Decision No. 9062-(89/6), adopted
January 18, 1989

4. LIBERIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

The Executive Board adopted the following decision:

Paragraph 4 of Executive Board Decision No. 9014-(88/162) adopted November 2, 1988, shall be amended by substituting "no later than February 17, 1989" for "within three months from the date of this decision."

Decision No. 9063-(89/6), adopted
January 18, 1989

5. SIERRA LEONE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

The Executive Board adopted the following decision:

Paragraph 4 of Executive Board Decision No. 9006-(88/158) adopted October 24, 1988, shall be amended by substituting "no later than February 17, 1989" for "within three months from the date of this decision."

Decision No. 9064-(89/6), adopted
January 18, 1989

6. ZAMBIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

The Executive Board adopted the following decision:

Paragraph 4 of Executive Board Decision No. 9012-(88/160) adopted October 26, 1988, shall be amended by substituting "no later than February 17, 1989" for "within three months of the date of this decision."

Decision No. 9065-(89/6), adopted
January 18, 1989

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/89/5 (1/18/89) and EBM/89/6 (1/18/89).

7. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/89/14 (1/13/89) is approved.

APPROVED: July 19, 1989

LEO VAN HOUTVEN
Secretary