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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/9

10:00 a.m., January 23, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. K. Bush
J. de Groote	H. G. Schneider
	C. Flamant, Temporary
M. Finaish	T. Alhaimus
	M. Sugita
	K. Murakami, Temporary
G. Grosche	
	M. Rasyid, Temporary
R. K. Joyce	
	J. R. N. Almeida, Temporary
H. Lundstrom	
	A. S. Jayawardena
E. I. M. Mtei	
	B. Jensen
	J. E. Suraisry
	J. E. Rodríguez, Temporary
	A. Steinberg, Temporary
A. R. G. Prowse	A. V. Romuáldez
	R. Msadek, Temporary
N. Wicks	T. A. Clark
	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

A. de Capitani, IBRD. African Department: R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; A. Jbili, I. Kapur, I. S. McCarthy, M. Sidibé. Asian Department: K. A. Al-Eyd, M. J. Fetherston, I. Otani, D. A. Scott, S. Takagi. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; E. H. Brau, B. de Schaetzen. Fiscal Affairs Department: J. Baldet, C. Schiller. IMF Institute: A. Hilmy, Participant. Legal Department: W. E. Holder, Ph. Lachman. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: L. K. Doe, D. Hammann, K. A. Hansen, G. E. L. Nguyen, J.-C. Obame, M. Z. M. Qureshi, D. C. Templeman, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: E. M. Ainley, J. Bulloch, J. de la Herrán, J. J. Dreizzen, G. Ercel, V. Govindarajan, N. Haque, G. D. Hodgson, J. M. Jones, H. Kobayashi, M. Lundsager, A. Mustafa, J. K. Orleans-Lindsay, A. A. Scholten, Shao Z., A. J. Tregilgas, P. Verly.

1. ZAIRE - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the third review under the stand-by arrangement for Zaïre (EBS/84/271, 12/28/84).

The Deputy Director of the African Department made the following statement:

> A staff mission visited Kinshasa for about ten days, from January 8 to 18, to review developments in 1984, to complete the Article IV consultation, and to reach understandings on a program for 1985.
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> There are no basic changes regarding the situation in the first nine months of 1984 compared with the description in the staff paper. The staff can, nevertheless, update information relating to developments in the last three months of the year.
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> It was projected that the rate of inflation would be less than 20 percent in 1984. According to provisional data for December 1984, the cost of living index in Kinshasa increased by 18 percent from December 1983, which represents a sharp fall from the 100 percent increase recorded from December 1982 to December 1983. From January 2, interest rates on treasury bills have been reduced by 5 percentage points, bringing nominal rates to the range of 29-35 percent on an annual basis. Real GDP growth, originally estimated at 3 percent for 1984, has been revised to 2.5 percent. It may also be noted that the adjustments in the price of petroleum products have been made in accordance with the indications given in paragraph 6 of the letter of intent. On January 7, retail prices were raised by 23.3 percent for diesel, 31 percent for fuel, and 12 percent for petrol.
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> Zaïre satisfied its external obligations as foreseen in the program for 1984. A total of SDR 156.75 million was deposited in an account with the Federal Reserve Bank of New York, which is estimated to cover all payments due under bilateral agreements to Paris Club creditors for 1984. The last monthly payment of $7 million to London Club creditors was made in December, and monthly payments of $4 million will be made in the first quarter of 1985, pending the establishment of a new payment schedule. As regards creditors not represented in the Paris or London Clubs, progress has been made in reaching bilateral rescheduling arrangements with several of them.
>
> Commercial and invisible arrears have been reduced in 1984 by SDR 60 million, of which SDR 40 million by cash payments in foreign exchange as required under the program, bringing the

stock of such arrears to about SDR 120 million at the end of 1984. During the same period, external nondebt arrears of the Treasury have been reduced by SDR 24 million, compared with SDR 20 million required under the program.

In order to discharge external obligations in a satisfactory manner, the Bank of Zaïre had to make net purchases on the interbank market equivalent to about $18 million in September and of about $37 million during the last quarter of 1984. This contributed to a significant depreciation of the real effective rate for the zaïre from August to December, and the decline shown on Chart 1 until November 1984 continued in December. At the last fixing of January 18, the rate was Z 42.20 per dollar. As noted in the paper (EBS/84/271, page 4), the Bank of Zaïre's purchases created some perturbation on the interbank market in the second half of November from which the market does not appear to have fully recovered, partly because of a seasonal fall in export earnings from diamonds. Nevertheless, the margin between the parallel and the official exchange rates remains below 10 percent.

As a consequence of external debt payments in excess of original estimates, a reduction in external arrears of the Treasury somwhat higher than foreseen, and expenditures relating to the presidential election, there was considerable pressure on the execution of the government budget, although the deficit is not expected to significantly exceed the target set in the second review. Final data on credit outstanding at the end of December will not be known before the second half of February. On the basis of preliminary data, it seems that net credit to Government would be close to the subceiling and total net domestic assets will remain within the overall ceiling proposed in EBS/84/271.

Regarding the 1985 program, the tentative understandings reached during the recent mission still need to be reviewed by staff and management. If everything proceeds satisfactorily, the proposed program for 1985 and the Article IV consultation could be discussed by the Board simultaneously toward the end of March.

Mr. Alfidja stated that Zaïre was continuing to make steady progress within the framework of its adjustment program. Inflation was being brought under control, external payments obligations were being discharged in a timely fashion, and payments arrears were being reduced. Those achievements were all the more noteworthy given the weak price for copper, Zaïre's main export.

The present program was on track, reflecting an improved monitoring of developments in the economy and the implementation of additional measures as necessary, Mr. Alfidja noted. The staff had explained fully the circumstances leading to the authorities' request for a confirmation of the waiver of the end-June ceiling on net domestic assets and for a modification of the ceiling for end-December. In view of the overall satisfactory performance of Zaïre under the program, he urged the Board to approve the proposed decision.

Mr. de Groote said that he supported the proposed decision. During the Executive Board's discussion of the staff report for the previous review (EBM/84/164, 11/9/84), he had observed that Zaïre had joined the group of countries that had successfully corrected their economic situation under Fund-supported adjustment programs, a cause of great satisfaction for the Fund and an indication of the validity of the policies recommended by it. Zaïre was one of the top performers among those countries. The authorities' firmness of purpose was evidenced by their successful implementation of the program for more than two years, since they had pursued a trial adjustment program agreed upon with the Fund one year prior to the Board's approval of the present stand-by arrangement. While Zaïre's achievements would be remarkable for any country, they were even more encouraging given the reservations expressed at the outset of the program by Executive Directors and the country's disappointing performance under previous programs. He was particularly impressed by the faster than expected deceleration of the corrective price increases following the 77.5 percent devaluation of the zaïre in September 1983 and by the disappearance of the parallel exchange market. There had been considerable debate between the international experts and the authorities on those two policy issues, but the authorities' viewpoint seemed to be vindicated by the facts.

The larger than expected increase in the net subscription to treasury bills by the nonbank private sector was particularly welcome and largely unexpected given the current tight credit policy and the price adjustments following the devaluation, Mr. de Groote commented. Monetary financing of the deficit, one of the traditionally weak aspects of the Zaïrian economy, would be unnecessary if the current operations of the Central Government, excluding the amortization on the current external debt, remained in surplus and if a substantial proportion of household and enterprise savings continued to be invested in government paper. Furthermore, much-needed investment could increasingly be financed out of national savings. Could the staff indicate whether the subscriptions for treasury bills came primarily from households or from enterprises? How had the high interest rates influenced the demand for treasury bills?

The relationship between the different policy ingredients of Zaïre's program and its progress over time would be an interesting subject for further analysis, Mr. de Groote considered. President Mobutu had indicated in his letter of intent that the elimination of the parallel market and the spectacular reduction in the rate of inflation had resulted from strict control of the budget deficit and a restrictive monetary and credit policy. He himself would have thought, however, that the reorganization of the exchange system, by ensuring a better allocation of resources, had also been responsible for the success of the budget and credit policies and for the abatement of inflation. His point was one of interpretation, rather than criticism.

The stance of adjustment policies had been on the cautious side, Mr. de Groote observed. The Zaïrian authorities should be commended for having pursued a no-risk approach to adjustment and for having shown no hesitation in offsetting the effects of an accounting error on the net domestic assets by curtailing credit to the public and private sectors. As the error had been unknown when the credit ceilings had been negotiated, the temptation could have been strong for the authorities to attempt to maintain existing policies by negotiating an increase in the ceilings. Their willingness to adapt their policies was a sign of their intention to pursue a sound economic adjustment program.

The formulation of an appropriate credit policy in the wake of an exchange reform that had established a new relationship between supply and demand for internal and external resources was a matter of great delicacy, Mr. de Groote remarked. The resilience of the Zaïrian economy had impressed the international community. In spite of a crowding out of demand for credit from the private sector, real GDP had increased more rapidly than in most African countries, and private investment had risen following the restoration of confidence in the economy, hardly a surprising development considering the country's exceptional growth potential. The highly conservative credit targets agreed by the authorities and the staff had been appropriate to restore confidence, as evidenced by the favorable attitude of members of the London and Paris Clubs. Confidence depended not only on the observance of payments obligations but also on the pursuit of appropriate policies by the authorities and their willingness to react to any slippages in the program, even if they resulted from exogenous factors. All of those considerations should be borne in mind in the formulation of a new program with Zaïre.

The elimination of inflationary pressures, restoration of the public finances, and better than expected current account performance indicated that there was no longer any risk in expanding credit to the private sector moderately, Mr. de Groote considered. Local manufacturing and agricultural enterprises should have access to credit so that they could increase investment in capital goods, thereby ensuring sustainable economic growth and a balance of payments position less dependent on the export of minerals.

In order to maintain the momentum of the Zaïrian recovery and the confidence of the international community, there should be no gap between the present program and any follow-on programs, Mr. de Groote stated. The indicative ceilings already negotiated for March 1985 were therefore particularly important. The staff had indicated in its paper that debt service before rescheduling would amount to 50 percent of exports in 1985 and that the authorities intended to approach the Fund for a new program that would assist them in closing the SDR 530 million financing gap projected for that year. According to the medium-term balance of payments outlook for 1985-89, Zaïre would not attain a current account surplus before 1988 and would achieve a viable balance of payments position only toward the end of the decade. Strict demand management and structural reform would therefore be required for a number of years. A large increase in public and private capital flows, through rescheduling and net lending, would also be necessary.

Given Zaïre's successful performance under the adjustment program, Executive Directors should be willing to give a mandate to the staff to continue assisting the authorities on their road to recovery, Mr. de Groote concluded. A reorganization of the state enterprises would be the centerpiece of any new program. Some positive steps had already been taken in that direction, and he welcomed particularly the reorganization of the state mining company (GECAMINES). The participation of the World Bank or IFC and the privatization of some enterprises might be helpful in that respect.

Mr. Joyce noted that, despite some technical and substantive problems with the program, the results had been generally satisfactory. Demand management had been tightened, and exchange rate policy had been adjusted successfully. Consequently, the economy had improved significantly since the introduction of the adjustment program. Inflation had fallen dramatically; GDP growth in 1984 had been nearly twice as rapid as in 1983; the parallel exchange market had apparently disappeared; debt service performance had improved; notwithstanding the unanticipated weakness in copper markets, the balance of payments position had improved as well.

He was concerned, however, about the number of waivers of performance criteria that had been requested during the program period, Mr. Joyce remarked. At the present meeting, the Executive Board was being asked to waive the ceiling on net domestic assets of the banking system, the third request for a waiver. The need for further modification raised some questions about the authorities' ability to implement the credit policy of the adjustment program and about the design of the program. The credibility and effectiveness of a program depended on the establishment of appropriate quantitative performance criteria at the outset.

The June 1984 ceiling for net domestic assets had been exceeded by an even greater margin than had originally been thought likely because of an accounting error, Mr. Joyce noted. An error of that magnitude suggested that the Bank of Zaïre required increased technical assistance, and he was pleased that five experts from the Fund were helping to provide such assistance. As the program was basically on track and the difficulties were largely attributable to statistical problems, he could support the requested waiver and modification of performance criteria. He would, however, appreciate some comment from the staff about the appropriateness of the mix between public and private credit in the economy. How might the credit ceilings have been set more effectively? How could such waivers and modifications be avoided in future programs?

On more specific aspects of the program, Mr. Joyce expressed disappointment that the budget deficit was expected to be larger than originally programmed. Revenues had increased considerably in 1984, but the authorities had not exercised sufficient control over expenditure. That situation was of some concern as the Executive Board had been asked to approve a request for a higher ceiling on net domestic assets, excluding credit to the Government, while the staff currently informed the Executive Board that some crowding out had occurred because a large share of the new credit was being absorbed by the Government. The ceiling on credit to the Government might, in fact, have been set too high in the past.

A few encouraging signs were beginning to appear in the management of the public enterprises, although there was still a long way to go before their financial situation stabilized, Mr. Joyce considered. The recent steps taken to improve the operations of Air Zaïre and the Zaïrian Shipping Company (CMZ) were welcome. However, the precarious cash flow situation of the state-owned petroleum company (PETROZAIRE), owing partly to delays in adjusting retail prices for petroleum products in response to the devaluation, was disappointing. The effect of a devaluation should be passed through to domestic prices if the exchange rate adjustment were to have any impact on the domestic economy. He looked forward to World Bank assistance in the restructuring of those enterprises.

He found it curious that the Bank of Zaïre imposed quantitative limits on credit to the private sector, while nominal interest rates ranged from 25 percent to 36 percent, Mr. Joyce commented. With inflation at about 20 percent, nominal rates of that order of magnitude would yield real positive interest rates of 5-16 percent, which were extremely high by any standards and should themselves deter demand for credit from the private sector. He would welcome the staff's comment on that situation, particularly on whether the authorities were considering removing or placing less dependence on quantitative credit limits.

On the question of arrears, the authorities' failure to reduce the external nondebt arrears as programmed was of some concern, but he was pleased that the situation would be resolved by the end of 1984, Mr. Joyce stated. He encouraged the authorities to eliminate their domestic arrears expeditiously in an effort to control government expenditure. He was pleased to note that the Bank of Zaïre was meeting its obligations to the Paris and London Clubs and was dealing with commercial and invisible arrears in a systematic fashion.

He hoped that the improvements in the economy in 1984 would provide the base for progress in 1985, Mr. Joyce remarked. The authorities should maintain firmer control over fiscal and monetary policy and should extend the adjustment effort to all sectors of the economy. Certainly, any follow-on program should strike a more appropriate balance of restraint between the public and private sectors. Much more intensive efforts should be made to correct the serious financial difficulties in the parastatals. The success in reforming the exchange market thus far must be continued, and the authorities should consider the staff's suggestion to shift additional transactions from the Bank of Zaïre to the commercial banks. Measures could usefully be taken to strengthen the interbank foreign exchange market given the temporary disruptions following large purchases in that market by the Bank of Zaïre.

It was too early to determine whether an appropriate follow-on Fund-supported program could be negotiated with Zaïre in the next few months, Mr. Joyce noted. Present adjustment efforts must be maintained and reinforced so that economic progress would continue. Zaïre's situation would improve considerably if copper prices recovered, but the country must be in a suitable position to take full advantage of any such recovery.

Mr. Flamant remarked that it was not too early to draw some conclusions from the results achieved by Zaïre under the stand-by arrangement. The authorities had achieved more than had been expected at the outset of the program, but much remained to be accomplished in structural reform, which was largely the province of the World Bank. The authorities should be commended for the impressive performance of the economy in 1984. Real economic growth had been 2.5 percent, rather than the 2 percent originally projected, and inflation was estimated to have been 18 percent compared with an initial projection of 47 percent. Those results indicated the authorities' strict adherence to tight fiscal and monetary policies.

The budget deficit represented only 0.7 percent of GDP, despite some increases in revenues and expenditures, Mr. Flamant noted. Moreover, an increasing proportion of that deficit had been covered by nonbank financing. In view of the excessive level of real interest rates in Zaïre, he was happy to note that the interest rate on treasury bills had been lowered to 28-34 percent for maturities of 28-91 days. That reduction was appropriate, but further action was necessary, as real interest rates on treasury bills ranged from 10 percent to 16 percent. A reduction in those rates would help to bring down other interest rates, which were also high in real terms.

The quantitative ceiling on credit to the private sector by commercial banks and the high interest rates could hamper the supply response of the economy, Mr. Flamant considered. He, therefore, supported the authorities' request for an increase in the ceiling on net domestic assets of the banking system for end-December 1984. On a related point, he wondered whether the waiver granted by the Executive Board at the second review had been as important as the staff had indicated. The multiple currency practice necessitating the waiver had been introduced in March 1984, and the Board had not been asked to grant a waiver until November 9, 1984. If the problem had been as serious as the staff suggested, he assumed that the Board would have been asked to grant the waiver earlier, perhaps at EBM/84/68 (4/30/84) or EBM/84/124 (8/8/84).

On the external side, the better than expected performance of the current account, due largely to the flexible exchange rate policy pursued by the authorities, was all the more remarkable given that copper prices had been well below the figure initially projected, Mr. Flamant said. The recent disturbances on the interbank market should not be overemphasized; they were the inevitable consequence of the functioning of a market still in an early phase of development. He commended the authorities for respecting the Paris Club and London Club agreements by making regular monthly payments and reducing external arrears, which had, in part, caused the disturbances on the exchange market.

The authorities should take advantage of the successes on the financial side to improve the supply response of the economy, particularly by implementing structural reform aimed at suppressing infrastructural bottlenecks and streamlining the operations of public enterprises, Mr. Flamant remarked. The Government had already taken a number of steps: audits had been conducted for several key enterprises, and some tariffs had been increased. However, extensive measures involving courageous political decisions would be required, particularly as the restructuring of public enterprises would involve a reduction in the number of employees. Various measures had already been taken to improve the operations of Air Zaïre and CMZ. Close cooperation between the Fund and the World Bank was essential, and he was disappointed that the staff paper had not contained more on the World Bank's involvement in Zaïre. He hoped that the Bank would respond quickly to the problems facing the Zaïrian economy. In view of the recent Joint Program of Action for sub-Saharan Africa and the proposal to establish a Special Fund for Africa, the World Bank should take a leading role in Zaïre and give sound advice to the authorities. In conclusion, he supported the proposed decisions and hoped that a new program would soon be presented to the Executive Board.

Mr. Steinberg noted that the authorities had successfully implemented the adjustment program. The sharp fall in the rate of inflation from 100 percent in 1983 to 18 percent on an annual basis in 1984 and close to zero in the second half of 1984 was most impressive, an achievement for which the authorities deserved the Fund's commendation. They had achieved that success by tightly controlling the budget deficit and restricting credit to the private sector, even to an extent that the staff considered excessive.

The contraction of public and private demand had moderated inflation and had also contributed to the improvement in the balance of payments position, mainly by slowing import growth in 1984, Mr. Steinberg remarked. The real devaluation of the zaïre between August and end-December 1984 had further improved competitiveness. The balance of payments position had also benefited from higher export proceeds, which had grown by

23 percent in 1984 despite the low and declining copper prices, owing to higher prices for cobalt and copper and increased exports of diamonds and oil. The exogenous factors to which Zaïre's exports were vulnerable underlined the need for economic diversification. Zaïre had managed to reduce its high dependence on copper from 50 percent of total exports in the early 1980s to about 35 percent in 1984.

The turnaround of the real effective exchange rate, which had depreciated between August and end-1984 following a significant appreciation in the preceding six months, had been due to the Bank of Zaïre's participation in the interbank market, Mr. Steinberg noted. Its intervention had not always been smooth, as market disruptions in mid-November attested. While a performance criterion related to net purchases of foreign exchange by the central bank could be instrumental in affecting exchange rates, it could better serve the purpose if it were phased over a longer period of time, given the variability of sales and purchases of foreign exchange.

The fiscal budget and the operations of public enterprises continued to be a source of concern, Mr. Steinberg considered. While the Treasury's control over the subaccounts was still not tight enough, the steps taken to improve the operations of some of the public enterprises were commendable. The Fund and the Bank should help the authorities to implement the auditors' recommendations in that sector.

The issue of treasury bills to finance the Government's deficit could contribute to the development of a money market, Mr. Steinberg remarked. However, interest rates on treasury bills, at 28-35 percent, were too high in real terms and were inconsistent with interest paid on other financial assets. To what extent had the introduction of treasury bills increased total savings? In fact, existing savings might have been diverted from the commercial banks to the Government, thus reducing the amount of credit available to the private sector and reducing the level of quasi-money. The lack of timely data on the official consumer price index limited the authorities' ability to take appropriate decisions on interest and exchange rates.

The substantial increase in the stock of treasury bills was a new factor for the authorities to consider when setting targets for money and quasi-money, Mr. Steinberg went on. Although treasury bills represented only 3 percent of total money and quasi-money, the increase in the amount of treasury bills--Z 535 million--had been much larger than the increase in total money and quasi-money--Z 336 million--in March-September 1984. The crowding out of the private sector from the credit market could be a dangerous development. Performance criteria should be used to ensure that the private sector received adequate credit. In conclusion, although several important areas deserved continuous attention, he was satisfied with Zaïre's performance under the adjustment program and he supported the proposed decision.

Ms. Bush remarked that Zaïre's performance under the current program had been successful overall. Although there had been some slippages in the budget, monetary policy had been tight, and, as a result, inflation had dropped dramatically. Furthermore, Zaïre had returned to a regular schedule of payments to foreign creditors, helping to restore a more normal relationship with both official and commercial lenders.

Developments on the export side had led to an overall increase in export revenues, despite the weak copper price, Ms. Bush observed. The rapid growth in exports of petroleum, coffee, and diamonds had probably been generated, in part, by exchange rate depreciation, and she encouraged the authorities to continue with their flexible exchange rate policy. The Government must continue to make regular foreign exchange purchases to meet its scheduled foreign obligations, and she hoped that such purchases would become a more regular occurrence in order to avoid the disruption that had occurred late in 1984, when the private sector had been temporarily closed out of the market. With respect to Table 2 of EBS/84/271, why had the item "Goverment, n.i.e." of the services account been two and one-half times as large in 1984 as originally programmed?

As for future developments, a tight fiscal policy should continue to be of high priority, Ms. Bush commented. The slippages in the fiscal objectives for 1984 would apparently not be repeated, owing to changes in administrative procedures, but Zaïre's foreign exchange budget could not absorb the higher import demand that would result from a less restrictive fiscal policy. Credit had been tight, particularly to the private sector, which had borne the brunt of the adjustment efforts. In order to provide some liquidity to that sector, she was willing to go along with the modification of the December credit ceiling. In the future, however, credit to the private sector must be provided on a regular basis, and she therefore welcomed the abolition of sectoral subceilings. Zaïre clearly needed to broaden its economic base to encourage growth and employment; the private sector was one of the most efficient generators of new jobs and higher incomes.

As Zaïre's financial situation might not ease for some years, the Government should continue to reduce its absorption of domestic and foreign resources, Ms. Bush remarked. The continued emphasis on the reduction in domestic arrears was appropriate and would contribute to the recovery of the private sector.

She supported the ongoing reform of public enterprises, particularly the modifications that had taken place in the airline and shipping companies, and she hoped that the audits of other enterprises would lead to similar comprehensive changes in those organizations, Ms. Bush stated. A restructuring of the petroleum sector could lead to a more market-determined system of pricing and allocation, thereby avoiding the disruption in the local markets that had occurred in the past month. The completion of the reorganization of GECAMINES was a welcome development, and she strongly supported Fund and Bank efforts to increase the transparency of the company's operations. She looked forward to a discussion of the Fund and Bank evaluations of that new entity in the forthcoming Article IV consultation. In conclusion, she supported the proposed decision.

Mr. Grosche agreed with other speakers that the program was basically on track and that adjustment had gained momentum. The overall situation remained precarious, however, and the progress achieved thus far seemed fragile. The increase in the GDP deflator in 1984 had been steep and contrasted unfavorably with developments in the consumer price index (CPI), suggesting that some sizable price increases were still likely. Could the staff commment on that possibility? Any follow-on program must be comprehensive in order to sustain the adjustment effort.

On the fiscal side, efforts to rehabilitate the public enterprises and strengthen monetary and external policies should be maintained, Mr. Grosche stated. The widening of the budget deficit was disappointing, although the revised projections for 1984 represented an improvement compared with 1983. The public sector had suffered from a lack of central control over spending; would the measures introduced in mid-1984 to improve central control over disbursements be adequate? He was also concerned about the appropriateness of petroleum prices and public tariffs. Further action was needed to bring prices in line with costs so as to avoid an unnecessary burden on the budget.

Credit demand by the Government, which far outweighed credit demand by the private sector, was another cause for concern, Mr. Grosche considered. Any follow-on program should aim at increasing credit to the private sector.

While progress had been achieved in the public enterprise sector, further action was required, Mr. Grosche noted. A precise timetable for restructuring those enterprises was an essential ingredient of the next adjustment program. Further progress in streamlining the public enterprises was important to improve the budgetary position and strengthen the overall efficiency of the economy. He welcomed the involvement of the World Bank in that effort.

As for external policies, he was glad to note the authorities' commitment to meeting their obligations under the rescheduling arrangements, Mr. Grosche stated. Furthermore, the Bank of Zaïre was already making monthly payments in advance of the formulation of a new payment schedule with the Paris Club. However, the need to meet external obligations in accordance with the program targets had demonstrated the vulnerability of the foreign exchange market. Unfortunately, the Government's need for foreign exchange had curtailed the availability of foreign exchange to the private sector. In the future, the authorities should approach the exchange market in a more balanced fashion. Overall developments in the external sector continued to be satisfactory, despite the poor market for copper, on which Zaïre was particularly dependent. Although higher than expected receipts from other commodities had compensated for lower earnings from the sale of copper, Zaïre's external position was still vulnerable, and the financing gap would remain high in the medium term. Adjustment would be necessary for Zaïre to reach a viable balance of payments position.

The recent deceleration in the rate of inflation had made interest rates largely positive in real terms, Mr. Grosche observed. He welcomed the recent simplification of the system of credit ceilings as a result of the abolition of sectoral subceilings. Finally, he supported the proposed decision regarding the modification of the credit ceilings, which should allow more room for private sector activities without jeopardizing the adjustment program.

Mr. Wicks congratulated the authorities for keeping the program broadly on track and, particularly, for the progress made in reducing inflation and respecting their external debt obligations. Those successful efforts would undoubtedly make a good impression on Zaïre's creditors, whose support would be needed during the next phase of adjustment.

Nevertheless, Zaïre's economy remained delicate, especially in view of the heavy debt service obligations in the next few years, Mr. Wicks observed. In order to strengthen their adjustment effort, the authorities should maintain the present thrust of their monetary and exchange rate policies, but they would need to improve their control over public expenditure and intensify their efforts to reform the public enterprise sector.

Fiscal policy should be the central element of a follow-on program, Mr. Wicks considered. Inadequate control over extrabudgetary outlays had contributed to the higher than programmed fiscal deficit in 1984. It would be disappointing if the success already achieved under the present program were jeopardized by a lack of sustained efforts by the authorities to control expenditure. While recognizing that revenue performance had been better than projected, he wondered whether the rising trend of revenues could be sustained. As the authorities could not rely on continuing revenue increases to offset any rise in expenditure in 1985, they should introduce appropriate measures at all levels to control domestic outlays. Perhaps some measures to control extrabudgetary disbursements should be made prior actions under the next program. Could the staff comment on that possibility?

The targets for the overall budget in 1985 had already been established, and the budget was expected to be finalized at the beginning of January during a staff visit to Zaïre, Mr. Wicks noted. Could the staff or Mr. Alfidja inform the Executive Board of any further developments in that regard? He understood that the 1985 budget envisaged increases in both revenues and expenditures of over 30 percent and that the fiscal deficit was projected to be Z 3.5 billion, or approximately 1 percent of GDP. Could the staff or Mr. Alfidja comment on the assumptions underlying the revenue and expenditure increases and how the deficit was to be financed? On a point of detail, the budget allowed for a 24 percent increases in salaries, while early wage settlements were reported to be higher, at 27-55 percent in the banking sector, for example. Were the authorities confident that they could keep to their target for salary increases?

While the progress made to date in restructuring the parastatal enterprises, particularly Air Zaïre and CNZ, was welcome, broader restructuring efforts were called for under the next adjustment program, Mr. Wicks considered. Realistic pricing policies should be introduced in the remaining parastatals such as PETROZAIRE. Following the completion of the external audits, the authorities should take the necessary action to restructure those enterprises as soon as possible. There might be scope for increased involvement of the private sector, or for foreign investment, in some cases. A timetable for the proposed reforms should be set out in the next program. He hoped that future staff papers would include more detailed discussion of the World Bank's view on structural reform in the parastatal, agricultural, energy, and industrial sectors.

On monetary policy, the authorities should continue to exert downward pressure on the growth of the monetary aggregates, Mr. Wicks suggested. He congratulated them on their flexible approach to marketing treasury bills, but he was somewhat perplexed by the operation of credit policy and would be interested in the staff's reply to Mr. Joyce's questions. The fact that the Government was projected to account for 62 percent of absolute credit expansion in 1984, despite the relatively tight fiscal policy, was worrying as it would entail some crowding out of the private sector. The authorities should attach high priority to remedying that situation, in particular through an improvement in the fiscal balance.

On the external side, measures to close the projected financing gap of SDR 530 million for 1985 would clearly have to be outlined before the Fund could agree to a follow-on program, Mr. Wicks commented. Could the staff indicate the precise timetable for discussing measures to close the gap? Zaïre's previous use of Fund resources was such that the level of new Fund credit would be limited.

He had been somewhat dismayed at the size of the excess over the June credit ceiling, but as the growth of broad money was expected to slow to 27 percent in 1984 compared with the 35 percent originally programmed, he could support the waiver granted in November, Mr. Wicks indicated. He also agreed with the proposed increase in the December ceiling on net domestic assets in view of the explanation provided in the staff paper. Finally, he supported the proposed decision.

Mr. Coumbis remarked that the overall economic performance of Zaïre continued to be good and that the adjustment program for 1984 remained on track. He therefore supported the proposed decision. A few disturbing developments in the economy should, however, be tackled decisively by the authorities as soon as possible so that a follow-on Fund-supported adjustment program could be formulated.

First, government expenditure had increased during the first nine months of 1984 at a higher rate than projected, Mr. Coumbis noted. Total expenditure had been revised upward for the fourth time in 1984, and was expected to amount to about Z 26.5 billion, 10 percent higher than the estimates made in October. However, as revenues had also increased by the same amount, the overall budget deficit would be Z 1.25 billion, slightly lower than previously estimated. As the deficit would be largely financed by sales of treasury bills, the performance criterion on net credit of the banking system to the Government would be met. That performance criterion should be considered as a minimum target, however, and Zaïre, in order to respect the substance of the program, should adopt tighter policies to contain the fiscal deficit and avoid crowding out the private sector. The sizable expenditure overruns had been due to inadequate control over spending by the decentralized agencies and over the Treasury's subaccounts, despite the measures taken by the authorities in June to monitor disbursements more closely. Could the staff indicate whether the subaccounts were finally under the strict control of the authorities, or whether there would be further overruns in the future?

Second, the Executive Board had granted a waiver in November of the June ceiling on net domestic assets, which had been exceeded by Z 176 million as a result of an accounting error, Mr. Coumbis recalled. However, that ceiling had in fact been exceeded by Z 809 million. The quality of the data had been questionable, and a technical assistance mission had been proposed. Could the staff comment on any developments in that area?

Third, some progress had been made in restructuring the public enterprises, Mr. Coumbis noted. Nevertheless, despite the initiation of new studies and external audits of some of those enterprises, more positive results were not expected before June 1985. He wondered whether any progress been made in preparing an inventory of the arrears of the public enterprises, which should have been completed in November 1984. Difficult restructuring measures should be introduced and strictly enforced to improve the efficiency of those enteprises.

Fourth, the medium-term balance of payments prospects presented in EBS/84/213 (10/12/84) had not been revised, even though the assumptions underlying those projections had changed substantially, as evidenced by the staff's recent forecasts for 1985, Mr. Coumbis commented. The price of copper was projected to decrease from $0.65 per pound instead of rising gradually to $1.10 per pound, while earnings from exports of petroleum, diamonds, and coffee were expected to increase. Furthermore, estimates of external debt obligations had also changed. Could the staff indicate its current views on the medium-term prospects for Zaïre's balance of payments? The staff had indicated that GDP growth was expected to be 3.5 percent in 1985. Could it provide details on the origins and causes of that increase?

Mr. Lundstrom noted with satisfaction that the program was still on track and continued to be implemented successfully. The balance of payments position in 1984 was expected to be better than previously projected, despite the continued weakness in copper prices. Furthermore, the outlook for 1985 pointed to a further improvement. Even though the zaïre had depreciated sharply in recent months, the rate of inflation had continued to decline. Real output growth in 1984 was estimated to have been significantly higher than in 1983, and prospects for a sustained increase in overall activity appeared to be better than at any time during the past few years. Those achievements, together with the settlement of external debt service obligations on schedule, had strengthened confidence in the Zaïrian economy.

Nevertheless, a great deal remained to be done, Mr. Lundstrom remarked. Substantial financing gaps were envisaged in the coming years, despite the recent improvement in the external sector. To close those gaps, the authorities intended to approach the Fund for a new stand-by arrangement and to seek further debt rescheduling from external creditors. While his chair would study such requests with an open mind, he urged the authorities to pursue vigorous adjustment policies and keep tight control over domestic demand in the years ahead.

The financial position of a number of the public enterprises had been a cause for serious concern, Mr. Lundstrom commented. The impact of the recent restructuring efforts on some of the those enterprises was to be reviewed by the Fund and the World Bank. To what extent were the authorities considering promoting foreign investment and domestic private participation in public enterprises? Had the World Bank completed its second study on public enterprises, and, if so, what were the major findings of the report?

As to the conduct of monetary policy, he welcomed the recent abolition of the sectoral credit ceilings and the introduction of one global ceiling, Mr. Lundstrom stated. The recent flexible approach toward sales of treasury bills was appropriate, but interest rates remained uncomfortably high at about 10-14 percent in real terms. Given the impact of those rates on the term structure of interest rates, further flexibility in the selling policy was called for. More generally, the present stand-by arrangement demonstrated that favorable results could be achieved, provided that the importance and consequence of the economic difficulties were fully recognized and that adjustment policies were implemented accordingly. In conclusion, he supported the proposed decision.

Mr. Jensen expressed support for the proposed decision. In spite of the weak copper prices in the world market, the authorities had pursued the adjustment measures necessary to meet the performance criteria. Unfortunately, some sectors of the economy had not performed so well; for example, credit to the private sector had been insufficient. He shared the concern of the authorities and the staff regarding the relatively weak performance of the public enterprises. Strong measures were necessary in that area to reduce internal imbalances and achieve a better allocation of the small amount of resources available for investment. He looked forward to continued assistance by the Fund for Zaïre's adjustment effort.

Mr. Mtei noted that economic management in Zaïre had generally improved and that the authorities remained committed to continuing their adjustment efforts. The program remained on track thus far, although the ceilings on net domestic assets had been breached. The notable signs of progress included the substantial decline in the rate of inflation, improvements in the external position, a pickup in the growth rate, and an improvement in the financial position of the Government. Nevertheless, the economy was not yet on an even keel. The authorities were experiencing problems in administering the budget, as evidenced by the expenditure overruns. He was also concerned that the Government was expected to absorb more than 60 percent of credit expansion in 1984, a practice entailing some crowding out of the private sector. In the absence of a modification of the ceiling on net domestic assets, private sector credit would have been curtailed even more sharply in December than at the end of the previous quarter.

The buildup of domestic arrears needed to be addressed in the near future in order to help to build confidence in the Government and to promote domestic economic activity, Mr. Mtei remarked. The potential for private investment in Zaïre was great, and appropriate policies should be adopted to ensure that private resources were exploited for the benefit of the population.

On the external side, the large debt service burden remained a constraint on the economy, Mr. Mtei noted. Debt service, including obligations to the Fund, would amount to almost SDR 1 billion or about 50 percent of exports in 1985. Debt rescheduling was clearly a necessity for Zaïre; a multiyear rescheduling arrangement would be most appropriate. Zaïre could also benefit from an increase in the flow of concessional aid if prudent economic policies were in place. He was concerned about the uncertainties surrounding the short-term and medium-term scenarios of the balance of payments, owing to depressed copper prices.

A number of public enterprises were facing serious financial problems, Mr. Mtei observed. He welcomed the efforts being made to improve their performance, but the restructuring efforts required perseverance if lasting solutions were to be found. In conclusion, he supported the proposed decision.

Mr. Zhang indicated his agreement with the proposed decision.

Mr. Finaish noted that the staff report stated on page 4 that "bilateral agreements have been signed with all Paris Club creditors, with the exception of Japan...." The staff had also indicated that some agreements had been reached with non-Paris Club creditors. However, no agreement had been reached to reschedule large overdue payments to the United Arab Emirates with respect to a $115 million loan made in 1974. The U.A.E. authorities had indicated their willingness to reschedule the loan and waive the penalties. No response had been received from the authorities of Zaïre. He had already been in touch with the staff on that matter and would continue to follow through on the problem.

He had to take a balanced view on the question of overdue payments because he represented both debtors and creditors, Mr. Finaish commented. The Executive Board should remember that many of the countries in his constituency had been generous in providing financial assistance. A number of national and regional institutions had been established in the 1970s to provide financial assistance, a large part of which had been extended to sub-Saharan Africa. The Fund should, within its regulations, help those institutions to continue to play an important role, particularly since they were at a disadvantage with respect to both experience and expertise in dealing with the problem of arrears.

The Deputy Director of the African Department noted that many Executive Directors had been concerned about the crowding out of the private sector by the public finance sector. The authorities were conscious of the problem and had been making progress in the past two years toward reducing the share of total credit expansion used to finance the budget deficit. That share had declined from 80 percent in 1982 to 62 percent in 1983 and was expected to fall below 50 percent in 1985. The staff had stressed that output growth would come essentially from the private sector, which would need to receive a larger share of credit expansion.

The authorities' control over the Treasury subaccounts appeared to have improved over the past year, the Deputy Director stated. Those accounts--with the exception of the counterpart funds of external assistance--would be integrated into the budget in 1985. The public wage bill was likely to increase by 30 percent in 1985, in excess of the 24 percent originally projected. However, indirect benefits in the form of free rides for civil servants on the urban transportation system would be eliminated, a change that would facilitate controls by bus companies. Efforts would also be pursued to reduce further the number of civil servants on the payroll, which had already declined by 18,000 individuals in 1984.

Only about 15 percent of all treasury bills had been bought by private households, a development that was not surprising given that the smallest denomination of such bills had been, until recently, Z 50,000, equivalent to some $1,400, the Deputy Director explained. Although the attempt to sell treasury bills outside Kinshasa had been unsuccessful, the sales of treasury bills might have indirectly helped to raise savings by inducing a shift from demand to term deposits, which had increased in terms of total deposits from 4.9 percent in December 1983 to 7.4 percent in June 1984.

Net outstanding credit to the private sector, which included parastatals in the staff's definition, remained very low, equivalent to only 7 percent of Zaïre's export earnings, the Deputy Director indicated. Several Executive Directors had expressed their satisfaction that the sectoral subceilings for credit from the commercial banks had been eliminated. By raising progressively the credit ceilings imposed by the Bank of Zaïre to commercial banks while maintaining sufficiently high real interest rates, the authorities could progressively reduce the role of quantitative ceilings in allocating credit to the private sector. The Government could respect its credit subceilings by accumulating domestic arrears, which would indeed tend to crowd out the private sector, as a number of Directors had noted. Considerable efforts had been directed toward improving information about domestic arrears, and a special commission would be created to analyze the claims of various parastatals and other enterprises.

The problems of the parastatals would best be solved by focusing restructuring efforts on those enterprises with the most severe problems, the Deputy Director commented. The Fund staff had worked closely with the World Bank staff in identifying problem areas. Rapid action within a specific timetable was called for, rather than ambitious studies of the entire public enterprise sector. The authorities were seriously considering suppressing the import monopoly of PETROZAIRE and giving other oil companies the opportunity to import petroleum products. The possibility of establishing a credit line for the importation of petroleum products was being discussed with commercial banks.

GDP growth in 1984 had come primarily from the export sector, the Deputy Director observed. The increase in exports of diamonds, cobalt, and oil had more than offset the decline in export earnings from copper. The agricultural sector, rubber, and coffee in particular, had also contributed to GDP growth.

With sharp modifications in the exchange rate, the GDP deflator could not be accurately measured, the Deputy Director remarked. The staff used the monthly cost of living index in Kinshasa, computed by the Statistical Institute of Zaïre with a time lapse of less than two months, to calculate the real effective exchange rate.

The staff had recently reduced its 1985 projections for the price of copper from 65 cents per pound to 61 cents per pound, approximately the price prevailing at present, the Deputy Director said. A one-cent decline in the price of copper represented a drop in revenues of $11 million. Exports of other products, however, would help to increase revenues in the future. With appropriate rehabilitation, the KILOMOTO gold mine could be producing up to ten tons of gold a year in about five years; exports of tin and agricultural products such as coffee, timber, and rubber could also increase substantially; Zaïre's potential for forestry exports was the largest in Africa and one of the largest in the world. The medium-term balance of payments projections and the underlying assumptions would be reviewed prior to the Executive Board's discussion of the 1985 Article IV consultation.

As for the interbank market, some Directors had suggested that additional foreign exchange transactions should be shifted from the Bank of Zaïre to the commercial banks, the Deputy Director noted. The foreign exchange budget of the Bank of Zaïre would be reduced to less than 50 percent of export earnings in 1985. That share would be further reduced if imports of petroleum products were liberalized, since foreign exchange purchases for those products would be shifted from the Bank of Zaïre to commercial banks. A broadening of the interbank market was called for in order to avoid the perturbations that had occurred in November.

The Bank of Zaïre would pursue a flexible exchange rate policy, the Deputy Director stated. The zaïre had depreciated by more than 10 percent--from 38 zaïres per dollar to 42.2 zaïres per dollar--between end-September and January 18, 1985, compared with a depreciation of about 3 percent for most European currencies. A further decline in the real effective exchange rate was needed to improve the balance of payments situation.

As for rescheduling arrangements with the commercial banks, the Deputy Director of the African Department commented, he had recently had discussions with members of the Secretariat of the Paris Club and with the Steering Committee of the London Club. The head of Zaïre's External Debt Agency was planning to travel to Paris toward the end of February to discuss specific problems regarding service payments due before rescheduling in 1985. The staff was suggesting that the repayment schedule should be linked to developments in the price of copper; the payments to the banks would be accelerated if the price of copper exceeded a given figure. Such an arrangement would encourage the authorities to reduce arrears rather than increase expenditure should the price of copper recover.

Mr. de Groote welcomed the fact that Zaïre's creditors might envisage an acceleration of reimbursements if the price of copper rose, an approach that he had proposed several times in the past. On a purely voluntary and case-by-case basis, the creditors and the debtor country could agree to establish a functional relationship between the country's reimbursement obligations and the evolution of the price of its main export commodities. For such a system to be coherent and balanced, however, reimbursement obligations should be reduced during periods of commodity price decline. Could the staff comment further on that approach?

The staff had indicated that by far the largest share of subscriptions to treasury bills originated from enterprises rather than from households, Mr. de Groote noted. Did that mean that the credit ceilings under the program had not been as stringent as originally envisaged? Or were the present high interest rates on treasury bills overcompetitive, thereby removing the incentives for enterprises to reinvest their savings to expand their operations? Did some regulations discourage enterprises from investing through self-financing? There was an analytical difference between monetary financing of the deficit and purchases of treasury bills by enterprises. If, in fact, enterprises were prevented, directly or indirectly, from reinvesting their financial surpluses, the result would be a crowding out of the private sector.

Mr. Zhang remarked that it was possible from the table on selected economic and financial indicators to determine the contribution of the different sectors to the growth in GDP in previous years, but such information could not be calculated for future years. Perhaps the staff should include projections for future years in such tables.

Mr. Wicks stated that Mr. Zhang might be interested in knowing that much useful information could usually be found in the World Bank staff reports. He was still concerned about the possible sources for filling the substantial financing gap of SDR 530 million projected for 1985.

The Deputy Director of the African Department explained that in calculating the financing gap for 1985, the staff had included purchases by Zaïre from the Fund totaling SDR 70 million available under the current program, but it had not included any possible additional financing from the Fund. On the basis of unofficial discussions with the Paris and London Clubs on the possible terms of rescheduling arrangements, it appeared that, with a new Fund-supported program, the gap could probably be financed. Since further reschedulings would be required in 1986 and 1987, it would be difficult for Zaïre to obtain new loans from commercial banks. The authorities were considering the possibility of promoting foreign investment in the form of equity capital; IFC involvement as a partner to foreign enterprises could provide confidence to potential investors. The inflow of equity capital could reduce the financing gap by increasing production and export earnings in future years. On a related point, the staff had been in close contact with Zaïre and the United Arab Emirates regarding Zaïre's overdue obligations and had indicated its willingness to arrange a technical meeting between the two parties to discuss rescheduling arrangements under terms similar to those of the Paris Club agreement.

The program provided limits on the possible crowding out of the private sector through financing the budgetary deficit by treasury bills, the Deputy Director noted: when the outstanding amount of treasury bills exceeded a given target, the subceiling on net credit to Government was reduced by the amount of that excess. Finally, as requested by one Executive Director, the staff would attempt to provide a sectoral breakdown of the sources of GDP growth and commodity breakdown of the growth in export earnings in its next paper.

The Deputy Director of the Exchange and Trade Relations Department said that the staff did not generally include forecasts in papers on recent economic developments, but in response to the comments by Mr. Zhang it would consider how best to incorporate some detailed information with respect to GNP projections into staff reports.

It was premature to discuss the details of an adjustment program for 1985, the Deputy Director remarked. There had not been final assessments of the sources of financing for the balance of payments gap in 1985, the nature of the adjustment program in that year, or the extent of access to Fund resources. With respect to the 1984 program, the widespread liberalization of the trade and payments system had been a lasting and fundamental change and one of the most important developments during the program period. The relatively free exchange and trade system, combined with the floating exchange rate, not only removed one of the impediments to the pursuit of appropriate public policies but also allowed for a more rational allocation of resources.

As to the multiple currency practice that the Executive Board had been asked to approve at the time of the previous review, the Deputy Director recalled that the staff had determined in October 1984 that the mandatory deposit system introduced by the authorities constituted a multiple currency practice. As Board approval for a waiver had been sought, the multiple currency practice had come under Fund jurisdiction, and plans for phasing it out by June 1985 had been established.

On a related point, he recognized that the staff was asking the Board's approval for the third modification of the adjustment program, a matter of concern to the staff, the Deputy Director from the Exchange and Trade Relations Department commented. All the modifications thus far had been necessitated by an accounting error that could be regarded as a purely technical problem. After considerable debate, the conclusion had been reached that the present modification was also technical in nature and was therefore consistent with the general policy on waivers. There was no realistic way of ensuring that waivers could be avoided in Fund programs. In Zaïre's case, the staff had deliberately aimed to ensure that the credit policy of the authorities would remain tight and had therefore established an ambitious set of targets, as reflected in the performance criteria. The adjustment program was fundamentally on track with respect to inflation, and the value of the zaïre was being stabilized.

Mr. de Groote indicated his agreement with the Deputy Director of the Exchange and Trade Relations Department: waivers were part of the very nature of the Fund's credit operations, as programs had to be adjusted to the evolution of developments in the borrowing country. Directors should not be unduly concerned about the need for waivers in the course of a stand-by arrangement. Waivers sometimes made it possible for a country to perform better than had been initially envisaged, as had been the case in Turkey.

He supported the technical assistance being given by the Fund to Zaïre, Mr. de Groote commented. The resident representative and the five experts assigned by the Central Banking Department were playing a useful role, as demonstrated by the fact that the accounting error had been identified as a result of their assistance. It would be beneficial if the Fund could provide assistance so that the Bank of Zaïre could publish regularly a complete survey of financial and economic statistics. Such publications could greatly help to restore confidence in the country.

Mr. Flamant stated that he was not sure that equity investment would be of much help in reducing the financing gap, at least in the short run, since at the outset such investments would be used to buy capital equipment and would, therefore, increase imports. In the long run, however, equity investment should increase exports.

The Deputy Director of the African Department, responding to a question from Mr. Lundstrom, indicated that the second World Bank report on the public enterprises in Zaïre would be issued within one month.

As for the exchange drawn by the Government from the Bank of Zaïre, the Deputy Director stated, the original target of SDR 50 million for 1984 had been grossly underestimated. About SDR 25 million had been spent to reduce the external arrears of the Treasury not related to the public debt, SDR 20 million to repay the arrears to GECAMINES, and about SDR 40 million to cover current expenses of embassies, military attachés, scholarships, travel abroad, and technical assistance. In addition, foreign exchange had been used for imports of equipment for the Government, notably military equipment. Repayments by the Government to GECAMINES related to uncompensated sales in earlier years, of which 51 percent was to be paid in foreign exchange. Nevertheless, government expenditure in foreign exchange had been on the high side in 1984, which was a subject of concern to the staff.

He could be sure that the uncompensated sales of GECAMINES had been eliminated only after the report of the external auditors had been issued, the Deputy Director of the African Department concluded. A World Bank mission would soon be visiting Zaïre, in part to examine the operations of GECAMINES. The repayment of the uncompensated sales made before the dissolution of the SOZADOM would remain a serious burden for the budget until at least 1986.

Mr. Alfidja remarked that the negotiations between the staff and the authorities for the next stand-by arrangement were soon to be completed. It was difficult at present, however, to provide details of the sources of financing the gap projected for 1985. His authorities aimed to formulate an adjustment program that would help to revive economic growth after two years of strenuous adjustment efforts. He assured Directors that his authorities were taking action to increase the role of the private sector in the economy. They considered that private sector participation was crucial for the achievement of a sustainable rate of growth in the medium term. Nevertheless, given the structural problems in Zaïre, there was still a long way to go. His authorities had shown their determination in implementing the current program successfully, and they remained committed to pursuing the adjustment effort with the help of the international community, including the Fund and the World Bank.

The Chairman made the following concluding remarks:

Directors noted with satisfaction the significant progress made by the Zaïrian authorities toward liberalizing the external sector of the economy, improving the balance of payments position, controlling inflation, stimulating growth, reducing external arrears, and respecting the country's external payments obligations. The adjustment program was, thus, broadly on track. Despite those achievements, however, Directors stressed that there were still several reasons for concern. The current account deficit remained close to 5 percent of GDP, and the debt service ratio--before rescheduling--was projected to be close to 50 percent in 1985 and was likely to remain high for several years. Zaïre would clearly have to maintain a stringent adjustment effort for a number of years.

Directors expressed disappointment about Zaïre's fiscal performance. Government expenditures had increased too fast, as evidenced by the repeated upward adjustments of the staff's fiscal estimates in 1984. Consequently, domestic bank financing of the deficit was expected to exceed the target set in the first review by Z 350 million. Those developments were all the more worrying because they had occurred in spite of the good revenue performance; the sources of the slippages were, thus, to be found on the expenditure side.

Expenditure overruns, rather than adverse exogenous factors, were the principal cause of Zaïre's disappointing fiscal performance, owing to inadequate control over spending by the decentralized agencies and over the Treasury's subaccounts. The Board could not be expected to keep supporting repeated use of Fund resources by a member that did not maintain strict control over all aspects of its economic policies. The authorities would have to show a significant improvement in fiscal performance in 1985.

While Directors noted with satisfaction that the larger than projected fiscal deficit had been financed by increased sales of treasury bills, some speakers expressed concern that the flow of savings toward such high interest yielding instruments might have pre-empted their productive use in the private sector. To avoid that crowding-out phenomenon in the future, attention would have to be directed at reducing the budget deficit in 1985. In that connection, Directors also stressed the need to reduce domestic arrears.

While some progress had been made toward improving the financial position of the public enterprises, major problems remained. The failure to raise petroleum prices in time to avoid major problems in the state-owned petroleum company, PETROZAIRE, was a manifestation of the authorities' inadequate control over the adjustment program. PETROZAIRE, which had a monopoly over petroleum imports, should pass on immediately to the consumer the effects of the devaluation of the zaïre in relation to the dollar. Even though the authorities had since decided to raise the retail prices of most petroleum products, close monitoring of developments should be maintained. Directors urged close collaboration between the World Bank and the Fund geared toward rapid action, rather than further studies, to restructure the public enterprises. They stressed the need for specific proposals for reform relating to those enterprises with particular problems, and a timetable for the introduction of restructuring measures in the framework of the 1985 program. A few Directors asked for fuller information about World Bank activities to be included in the future in Fund staff papers.

The considerable progress made in liberalizing the exchange system was one of the keys to the success of the adjustment program. A smoother intervention policy by the Bank of Zaïre would help to avoid abrupt exchange rate changes which had complicated the operation of the exchange market.

The Executive Board then took the following decision:

Review Under Stand-By Arrangement

1. Zaïre has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Zaïre (EBS/83/257, Sup. 2, 12/22/84) and the letter of the President of Zaïre dated September 12, 1983, with annexed memorandum, in order to reach understandings subject to which Zaïre may make further purchases under the stand-by arrangement. Zaïre has also requested the Fund

(a) to confirm the waiver of the observance of the performance criterion in paragraph 4(a)(iv) of the stand-by arrangement for end-June 1984, and

(b) to raise the ceiling on net domestic assets of the banking system for end-December 1984 by an amount of Z 400 million, without changing the subceiling on credit to the Government.

2. The letter of the President of Zaïre dated December 18, 1984 shall be attached to the stand-by arrangement for Zaïre, and the letter of September 12, 1983, supplemented by the letters of

March 26, 1984 and October 5, 1984, shall be read as supplemented by the letter dated December 18, 1984.

3. The Fund confirms the waiver as requested by Zaïre.

4. Zaïre will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Zaïre's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota during any period in which the ceiling on net domestic assets of the banking system at end-December 1984 in accordance with paragraph 13 of the letter of December 18, 1984 is not observed.

Decision No. 7890-(85/9), adopted
January 23, 1985

2. MALDIVES - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Maldives together with a proposed decision concluding the Article XIV consultation (SM/85/4, 1/2/85; and Sup. 1, 1/18/85). They also had before them a report on recent economic developments in Maldives (SM/85/11, 1/9/85).

Mr. Finaish made the following statement:

Notwithstanding the difficulties associated with a small, open economy consisting of scattered islands, and the greater vulnerability of such economies to external developments such as the recent international recession, economic performance in Maldives in the first four years of this decade has been quite satisfactory. Real GDP has grown at an average rate of over 7 percent, and inflation has been kept at an average rate of less than 6 percent. Policies aimed at infrastructural development, diversifying the economic base, expanding the export-oriented sectors, and maintaining financial stability have contributed to this favorable economic performance and to building up greater resilience in the economy.

In 1983, an unfavorable external environment marked by the continuing world recession and civil disturbances in a neighboring country adversely affected economic activity--especially in shipping, tourism, and construction--leading to a drop in the growth rate. At the same time, an expansionary fiscal stance associated with the ongoing development efforts contributed to increasing the growth of domestic credit and widening the current account deficit. Although some measures were taken to restrain liquidity growth, inflation rose.

Less expansionary policies at home and an improved external environment contributed to a turnaround in the economy in 1984. The GDP growth rate is estimated to have doubled during the year, while the inflation rate has been halved and the budget and external deficits reduced.

In the principal sector of the economy, fisheries, output has increased only modestly in 1984 over the substantial gains made in the previous year. While efforts aimed at the mechanization of fishing ships and improvements in fish collection and refrigeration facilities are continuing, larger projects for the modernization of the industry are under way with the assistance of some international agencies and the Kuwait Fund. These efforts have already begun to result in increased productivity. The authorities project further and larger productivity gains later in the decade, as the ongoing projects are completed and it becomes possible to fish beyond the current 30-mile limit. Meanwhile, reflecting improved marketing by the State Trading Organization (STO), fish exports have increased by 30 percent. Since the recently acquired cannery has been operating beyond full capacity and there seems to be a strong demand for its product, the authorities are planning to increase canning capacity.

Tourism, another key sector, recovered strongly in 1984 from its temporary setback of the previous year, partly as a result of improved availability of flights from Europe and the Far East. Growth in this sector has been rapid in recent years. However, the development of new capacity beyond the Male atoll, which is within easy reach of the airport, is constrained by a lack of efficient inter-atoll transportation.

Reflecting the general slump in world shipping, receipts from shipping are expected to be lower again in 1984. The authorities are responding by initiating a reorganization of the fleet, including a reduction in its size and capacity, with due regard to fuel efficiency. On the other hand, garment manufacturing has developed strongly, now accounting for nearly half of the country's exports excluding re-exports. To minimize the impact of quota restrictions on wool sweater exports, production has been diversified into other materials, notably cotton and synthetics.

A tightened fiscal stance emerged over the year, with the overall budget deficit turning out to be substantially less than that budgeted. Expenditures increased much less than expected: the execution of some projects was delayed, resulting from certain technical and external factors and not so much from a lack of implementation capacity as stated in the staff report, and some lower-priority projects were postponed for budgetary reasons. Revenues and grants, on the other hand, were greater than expected. Tax receipts increased largely as a result of the strong recovery in economic activity, especially in tourism. The staff notes that the increase in grants reflected disbursements on the unexpectedly large amount of commitments made by donor countries at the Paris meeting in July 1984; however, the authorities wish to point out that the higher level of grants was largely unrelated to such disbursements--as few of them have yet taken place--and that the commitments made at the Paris meeting could not be termed unexpectedly large.

In the coming year, owing mainly to increased development expenditure, most of which will be concentrated in the fisheries and transportation sectors, the budget deficit is expected to increase. Revenue growth, however, will benefit from several new measures, including increases in TV license fees, operating fees for outlets of imported merchandise and for restaurants, and rents of some government properties. As foreign grants are not expected to growth by much, there is likely to be some increase in borrowing both at home and abroad.

Monetary developments in 1984 were marked by a deceleration of domestic credit growth, resulting from the reduced fiscal deficit, a lower inventory requirement of the STO, and the measures taken earlier for controlling credit growth. Credit demand has also been restrained as a result of the higher effective cost of credit, arising from the advance deposits and compensating balances required by banks. Real interest rates in general remain positive and have contributed to increasing the share of time deposits in total bank deposits.

The authorities regard the continuation of appropriate restraint in liquidity growth as an important objective of monetary policy. In case further action is needed, the Maldives Monetary Authority, which has since its inception in 1981 taken several measures for better control over monetary aggregates, would consider using interest rates and sales of either treasury bills or savings certificates as possible instruments. Further increases in reserve requirements--which, because of past increases, now stand at 25 percent--are not considered advisable in present circumstances.

Although the export prospects have improved, the current account deficit is expected to remain high for some time because of the large import demand for development purposes. Since financing continues to be largely through concessional official sources, with a significant proportion in recent years contributed by the Arab oil exporting countries, the debt service ratio is not projected to increase in the medium term, as is also shown in the medium-term external debt profile presented in Table 5 of the staff report. The authorities wish to add, however, that they have reservations about some of the projections in that table.

The exchange system of the Maldives remains free of restrictions. In view of the recent appreciation of the rufiyaa, mainly because of its peg to the dollar, the authorities have been reviewing the current exchange rate system and have requested Fund technical assistance for the purpose of examining the various implications of any change in the rate or the system.

Mr. Murakami remarked that the economy of Maldives had been characterized by a remarkably high rate of GDP growth in the early 1980s. Although economic growth had slowed in 1983 as a result of unfavorable external developments, the performance of the economy had improved considerably during 1984. The slow growth in 1983 had, however, contributed to a marked weakening in the balance of payments. Adjustment measures taken by the authorities in 1983 and 1984, together with the more favorable external situation, had improved the external position in 1984. Nevertheless, the underlying structural weaknesses in the balance of payments were likely to persist.

Looking ahead, those structural weaknesses might be aggravated by the authorities' development policies planned for 1985-87, which aimed at increasing economic growth to about 9 percent annually, Mr. Murakami noted. The medium-term scenario, based on that growth strategy, indicated that the current account deficit would double by 1989 and that the overall balance of payments position would deteriorate significantly. Understandably, the staff had encouraged the authorities to adopt a strategy that would be more consistent with a sustainable external position over the medium-term and to intensify their adjustment efforts. He broadly endorsed the staff appraisal.

On fiscal policy, the measures recommended by the staff seemed appropriate given the need for a reduction in the fiscal deficit to support an improvement in the external position, Mr. Murakami considered. The introduction of new revenue measures in the 1985 budget was welcome. The staff, however, was calling for additional revenue-raising measures, and he wondered whether it could provide more information on the reform of the tariff system being considered by the authorities. On the expenditure side, owing to the country's limited capacity to implement the development projects planned for the year, the fiscal deficit in 1985 might be less than initially envisaged, as had been the case in recent years. The authorities should be more selective in undertaking development projects with the aim of using resources most efficiently, based on a realistic assessment of the implementation capacity of the country. At present, all expenditures on projects financed from foreign loans were outside budgetary control. The authorities should strengthen their control over the budgetary system.

His chair welcomed the more restrictive monetary policy in 1984 compared with 1983, Mr. Murakami indicated. The decline in the growth of domestic credit to about 18 percent annually in the third quarter of 1984 was attributable solely to the slow growth of domestic credit to the public sector as a result of the eventual sharp reduction in the fiscal deficit. At the same time, domestic credit to the private sector had expanded at an annual rate of more than 40 percent. Under those circumstances, the staff's suggestion for the authorities to tighten monetary policy by further strengthening reserve requirements seemed appropriate.

On the external side, the authorities' recent efforts to promote exports of both traditional and nontraditional products and to strengthen the service account were commendable, Mr. Murakami considered. However, like the staff, he believed that a more active use of exchange rate policy should be considered in combination with those efforts. The staff's suggestion to peg the rufiyaa to a currency basket, such as the SDR, rather than to a single currency, would at least help to avoid a large effective appreciation of the currency, as had occurred recently. Technically, it could be argued that a peg to a trade-weighted currency basket or a tourism-weighted basket would be more suitable for Maldives than a peg to the SDR. Could the staff comment on that point?

The fishing industry remained Maldives' principal economic activity, although tourism was developing rapidly, Mr. Murakami observed. The success of the fishing industry would be an important factor in determining economic progress in Maldives. Although the immediate outlook for fish exports was not bright, the medium-term outlook was more promising. After the disappointing withdrawal from Maldives of two foreign collecting companies during 1982-83, it was encouraging that the State Trading Organization had successfully handled those operations. However, he wondered whether it would have been easier if the transfer of those operations to the STO had been more gradual and systematic. That changeover of ownership indicated that both private investors and host countries should assess investment projects from the long-term perspective. Finally, he supported the proposed decision.

Mr. Suraisry indicated his agreement with the staff appraisal and his support for the proposed decision. Considerable progress had been made in 1984 in several areas: real GDP had increased substantially, inflation had been reduced, the overall fiscal deficit had declined, and monetary and credit policy had become less expansionary. While those improvements had been related partly to more favorable external developments, they had also been due to the authorities' commitment to adjustment. He commended the authorities for those results.

Nevertheless, the economy still faced deep-seated problems that would require further adjustment measures, Mr. Suraisry remarked. The authorities would be well advised to re-examine their development policies, particularly in view of the unfavorable assessment of the outlook by the Fund and Bank staff. Table 6 of the Appendix to SM/85/4 provided a clear picture of the adverse impact that such policies would have on the balance of payments in the medium term. He agreed with the staff that a less ambitious development program would be more appropriate.

Although Maldives' financial position had improved somewhat in 1984, it remained weak, Mr. Suraisry noted. The smaller than estimated overall fiscal deficit of 8 percent of GDP, although welcome, was clearly still too high and was expected to double in 1985. The budget deficit, although likely to be less than estimated and although financing was mostly on a concessional basis, would remain a burden on the balance of payments and would undermine the gains achieved in 1984. Consequently, he urged the authorities to restrain expenditure, which was projected to increase by 28 percent in 1985, and to raise additional revenues. The highest priority should be given to incorporating all government revenues and expenditures into the budget in order to maintain strict control over the Goverment's financial position. He was encouraged to note that the authorities were giving serious consideration to the staff recommendations in that area, but he recognized that those recommendations could be adopted only gradually, given the economic and social constraints.

He welcomed the tightening of monetary policy, but as the authorities recognized, there was a need for further monetary restraint so as to keep inflation low and to support the adjustment efforts in other areas, particularly on the external side, Mr. Suraisry remarked. Although he agreed with the staff that the monetary authorities could play a more active role in economic policy, that role would probably be limited for some time to come, owing to the low monetization of the economy.

On the external side, the authorities had made commendable efforts to expand exports, strengthen the services account, and pursue a free exchange system, Mr. Suraisry noted. They should maintain those efforts. More specifically, the staff suggestion to peg the rufiyaa to a basket of currencies would introduce more flexibility into the present exchange arrangement and would be best suited to the country's needs. He welcomed the authorities' request for technical assistance to assess, among other things, the appropriateness of such a move. The external debt remained manageable, but, given the external position and the country's capacity to repay debt, the authorities should be cautious in contracting new external borrowing, particularly short-term borrowing. The projected increase in total expenditure for 1985, part of which would be financed by external borrowing, was inappropriate. Every effort should be made to reduce the fiscal deficit and avoid excessive foreign borrowing in order to strengthen the balance of payments over the medium term.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/8 (1/18/85) and EBM/85/9 (1/23/85).

3. BANGLADESH - TECHNICAL ASSISTANCE

In response to a request from the Bangladesh authorities for technical assistance, the Executive Board approves the proposal as set forth in EBD/85/22 (1/16/85).

Adopted January 22, 1985

4. BOTSWANA AND SIERRA LEONE - TECHNICAL ASSISTANCE

In response to a request from the Governors of the Bank of Botswana and the Bank of Sierra Leone for technical assistance to review certain aspects of central and general banking legislation, the Executive Board approves the proposals as set forth in EBD/85/17 (1/15/85).

Adopted January 22, 1985

5. MALI - TECHNICAL ASSISTANCE

In response to a request from the Malian authorities for technical assistance in investment budgeting, the Executive Board approves the proposal as set forth in EBD/85/19 (1/15/85) and Supplement 1 (1/18/85).

Adopted January 18, 1985

6. SIERRA LEONE - TECHNICAL ASSISTANCE

In response to a request from the Sierra Leonean authorities for technical assistance relating to exchange rate arrangements, the Executive Board approves the proposal as set forth in EBD/85/24 (1/18/85).

Adopted January 18, 1985

7. EXECUTIVE BOARD COMMITTEES

The Executive Board approves the reconstitution of the membership of the four Executive Board standing committees as proposed by the Managing Director in EBD/85/18 (1/15/85).

Adopted January 18, 1985

8. PENSION COMMITTEE - NOMINATIONS

The Executive Board approves the election of the four Executive Directors nominated to serve as members of the Pension Committee for the term ending October 31, 1986, as set forth in EBAP/85/10, Supplement 1 (1/18/85).

Adopted January 22, 1985

9. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/87 through 84/89 are approved. (EBD/85/23, 1/16/85)

Adopted January 22, 1985

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/218, Supplement 1 (1/18/85) and EBAP/85/12 (1/17/85), and travel by an Assistant to Executive Director as set forth in EBAP/85/14 (1/17/85), is approved.

APPROVED: October 25, 1985

LEO VAN HOUTVEN
Secretary