

**FOR
AGENDA**

EBS/07/16

CONFIDENTIAL

February 14, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Zimbabwe—Restoration of Voting and Related Rights**

Attached for the consideration by the Executive Directors is a paper on Zimbabwe's restoration of voting and related rights. This paper, together with the paper on Zimbabwe's overdue financial obligations to the PRGF-ESF Trust (EBS/07/15, 2/14/07) and the staff report for the 2006 Article IV consultation with Zimbabwe (SM/07/58, 2/9/07), is tentatively scheduled for discussion on **Friday, February 23, 2007**. A draft decision appears on page 3.

It is not intended to publish this paper on the Fund's external website.

Questions may be referred to Mr. Lin, FIN (ext. 37299), Mr. Laryea, LEG (ext. 37794), Ms. Coorey, AFR (ext. 35359), and Ms. Alonso-Gamo, PDR (ext. 38375).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

Zimbabwe—Restoration of Voting and Related Rights

Prepared by the Finance, African, Legal, and Policy Development and Review Departments

Approved by Michael G. Kuhn, Abdoulaye Bio-Tchané, Sean Hagan, and Matthew Fisher

February 14, 2007

I. INTRODUCTION

1. **Following Zimbabwe's clearance in full of its arrears to the General Resources Account (GRA) on February 15, 2006, the Executive Board met on March 8, 2006 to consider the sanctions that had been imposed on Zimbabwe with respect to its GRA arrears (EBS/06/25, 02/22/06).**¹ Executive Directors expressed a range of views regarding the staff's recommendation on the restoration of Zimbabwe's voting and related rights in the Fund and the termination of its ineligibility to use the Fund's general resources. There was, however, insufficient support among Executive Directors to restore voting and related rights by the 70 percent of the total voting power needed to adopt the proposed decision.² Furthermore, because of the sequential nature of the sanctions imposed under Article XXVI, Section 2, the absence of a decision to lift the suspension of voting and related rights precluded the Board from adopting a decision to terminate Zimbabwe's ineligibility to use the Fund's general resources.³

¹ As a result of the GRA arrears clearance, the Managing Director withdrew his complaint with respect to Zimbabwe's compulsory withdrawal from the Fund (EBS/06/22, 2/15/06).

² EBS/06/25 (2/22/06) recommended that the suspension of Zimbabwe's voting rights be lifted immediately on the following basis: (i) Zimbabwe was no longer in breach of those financial obligations under the Articles of Agreement that gave rise to the decision to suspend voting rights (that is, its arrears to the GRA had been settled); and (ii) Zimbabwe no longer had any outstanding obligations to the GRA that could result in GRA arrears reemerging.

³ See Statement by the Acting General Counsel on the *Sequencing of Decisions Lifting Sanctions Contemplated in Article XXVI, Section 2, and on the Limits to the Discretionary Power Given to the Executive Board* (BUFF/06/44, 3/8/06). Provided the conditions for taking such a decision are met, a declaration of ineligibility may be terminated by a decision of the Executive Board adopted by a majority of the votes cast.

2. **Under Rules K-4 and K-7, the Fund is required to state the further actions that are required of Zimbabwe in order for the sanctions to be lifted.**⁴ In this context, since the March 2006 Board discussion, staff has consulted informally with Executive Directors on various possible ways to condition the restoration of Zimbabwe's voting rights, though a broad consensus could not be reached. This paper presents a proposal for conditioning the lifting of sanctions against Zimbabwe on a one-year track record of accurately reporting its international reserves, verified by external audits. On this basis, the paper also proposes a draft report from the Managing Director under Rules K-4 and K-7, setting out the proposed actions (Attachment I). By endorsing the report of the Managing Director, the Executive Board would specify the actions that would need to be implemented by Zimbabwe as conditions for Board consideration of lifting the sanctions.

II. LEGAL FRAMEWORK FOR CONDITIONING THE LIFTING OF SANCTIONS

3. **The scope of the Board's discretion in considering the lifting of sanctions under Article XXVI is circumscribed by the objective of the provision, namely, to address breaches of members' obligations under the Articles.** Accordingly, the considerations must be based on the resolution of a member's existing breach of obligations, or on the necessary actions to avoid a potential breach where there is a reasonable basis to conclude that a member may become in breach of its obligations in the foreseeable future.⁵ In addition, Board decisions in this regard must be taken consistent with the principle of uniformity of treatment, which requires similarly situated members to be treated similarly.

III. PROPOSAL

4. **It is proposed that the lifting of sanctions be conditioned on the actions necessary for Zimbabwe to avoid a potential breach of Article VIII, Section 5.**⁶ Specifically, the proposed conditions are that Zimbabwe should report international reserves (i) each month (with a lag of no more than one month) consecutively for a period of one year; (ii) according to a template that has been provided by Fund staff; and (iii) with verification each quarter through an external audit by an internationally-recognized auditing firm, applying

⁴ Rule K-7 of the Fund's Rules and Regulations states: "When a member, whose voting rights have been suspended, requests the Executive Board to terminate the suspension and the Executive Board decides not to terminate such suspension, a written report shall be presented to the member stating what further action is required before such suspension will be terminated." Rule K-4 requires a similar report in the case of a member's denied request to terminate a declaration of ineligibility to use the Fund's general resources. There have been no previous cases that necessitated a K-4 or K-7 report.

⁵ See BUFF/06/44 and EBS/06/25. Accordingly, Zimbabwe's arrears to the PRGF-ESF Trust are not a relevant consideration with respect to the lifting of sanctions imposed under Article XXVI, Section 2.

⁶ Given the absence of specific understandings on the aspects of reserve reporting at the relevant time, staff is not in a position to conclude that Zimbabwe has breached its obligations under Article VIII, Section 5 with respect to the *past* reporting of international reserves data. Box 1 describes the key concerns and subsequent discussions with the authorities.

International Standards on Auditing. The Reserve Bank of Zimbabwe will select the auditor through an open tender process using terms of reference agreed with Fund staff.⁷

5. **Establishing the condition for the lifting of sanctions on the basis of Article VIII, Section 5 is appropriate.** Accurate reserves reporting in accordance with Article VIII, Section 5 will help address a key concern expressed by a number of Executive Directors related to the sources of Zimbabwe's payments for clearing its GRA arrears to the Fund. The actions required of Zimbabwe under the proposed approach would also represent a significant improvement in reserve data reporting and transparency.

6. **The proposal is consistent with the legal framework described in Section II.** It will enable Zimbabwe to demonstrate sustained progress in enhancing its reporting of reserves data under Article VIII, Section 5, thus avoiding a potential breach of its obligations under that Article. Addressing Zimbabwe's case in this manner would also be consistent with principles of uniformity of treatment. It would recognize that the Fund is addressing circumstances that had not been previously confronted, that is, members under sanctions that have eliminated all of their arrears to the GRA, but where there is a reasonable basis to conclude that they may be in breach of another obligation (in this case, Article VIII, Section 5) in the foreseeable future. The proposed approach, which would be applied to future cases in similar situations, would also avoid creating a precedent for more onerous conditions that the Fund might be unwilling to apply in future cases.

7. It is important that the Fund follows through on lifting sanctions if the condition to be adopted in the Rules K-4/7 report is met. A decision by the Executive Board adopted by a majority of the votes cast would be required for Board endorsement of the condition for lifting sanctions. A decision by the Board to restore Zimbabwe's voting and related rights would require a 70 percent majority of the total voting power.

PROPOSED DECISION

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

The Fund endorses the report of the Managing Director set forth in EBS/07/16,
Attachment I.

⁷ An expert from the Fund would review the authorities' reserves reporting and Fund staff would determine whether the condition has been met.

Box 1. Zimbabwe—Reporting of International Reserves

Background. Following questions over the source of the August 2005 payment to the Fund, staff questioned the accuracy of Zimbabwe's reserves data. In late 2005, the Reserve Bank of Zimbabwe (RBZ) revised the end-July gross reserves upwards by US\$55 million and usable reserves for the whole year. Further, staff was also concerned about the apparent inconsistencies between international reserves data and reserves reported in the monetary survey.

Follow-up and Fund Procedures. In the absence of specific understandings between Zimbabwe and Fund staff on the reporting of international reserves data at the time the data was provided in 2005, staff has assessed Zimbabwe's reserves reporting against the general understandings for reporting such data under Article VIII, Section 5: when assessing a member's ability to provide information under Article VIII, Section 5, the Fund will give the benefit of any reasonable doubt to the member (See Decision No. 13183-(04/10), adopted January 30, 2004).

Staff Assessment. The reporting of the data in question essentially involved specific items that were not covered by the general understandings that would apply to the reporting of international reserves data based on standard statistical practices. First, standard statistical procedures leave some room for judgment whether specific reserve assets need to be classified as liquid or illiquid.¹ The RBZ adopted an internal concept of "illiquid assets" that did not match the Fund's concepts of pledged and encumbered assets. The authorities explained that data revisions primarily reflected the reclassification of "illiquid" reserve assets into "liquid." Second, Zimbabwe used data from its trading desk system and from its balance sheet for different reports. While a lack of internal reconciliations prevented identification of errors, the January 2006 mission was able to reconcile the gross foreign assets information in the reserves table and the monetary survey data, based on the 2004 audited financial statements.² Accordingly, in the absence of specific understandings on reserves reporting, recognizing that the reporting of the data in question was not covered by applicable general understandings, and giving the benefit of the reasonable doubt to Zimbabwe, staff is not in a position to conclude that Zimbabwe's initial reporting and subsequent revisions of reserve data were inaccurate for the purposes of Article VIII, Section 5.

Follow-up. During the December 2006 Article IV visit, staff provided the authorities with a template and accompanying explanation of the accounting and statistical practices for reporting reserves to the Fund. These understandings would form the basis for monitoring Zimbabwe's future compliance with its obligations under the Articles.

¹ Fund terminology refers to assets as free or encumbered. Pledged assets are free assets with an unexercised claim that will render them encumbered if exercised.

² These were the most recent audited statements available.

**ATTACHMENT I:
LETTER TO THE AUTHORITIES**

Honorable Samuel Mumbengegwi
Minister of Finance
Ministry of Finance and Economic Development
Harare, Zimbabwe

Honorable Gideon Gono
Governor
Reserve Bank of Zimbabwe
Harare, Zimbabwe

Dear Minister Mumbengegwi and Governor Gono:

I would like to take this opportunity to share with you the outcome of the Executive Board meetings held on Zimbabwe, which took place on March 8, 2006 and February 23, 2007. In light of Zimbabwe's clearance of its arrears to the Fund's General Resource Account (GRA) on February 15, 2006, the Board considered whether to lift the sanctions that had been imposed pursuant to Article XXVI, Section 2. These sanctions are: (i) the declaration of ineligibility to use the Fund's general resources; and (ii) the suspension of Zimbabwe's voting and related rights in the Fund. Directors also considered issues related to Zimbabwe's outstanding arrears to the PRGF-ESF Trust.

At both meetings, Executive Directors expressed their serious concerns over Zimbabwe's deteriorating economic situation and urged the authorities to implement a comprehensive policy package comprising several mutually reinforcing actions in the area of macroeconomic stabilization and structural reforms. These actions include: termination of quasi-fiscal activity by the Reserve Bank of Zimbabwe and transparent transfer of these activities to the budget; substantial fiscal adjustment; unification of the exchange rate and elimination of exchange restrictions with respect to the making of payments and transfers for current international transactions; price liberalization and imposition of a hard budget constraint on public enterprises; and adoption of a strong monetary anchor, as well as fundamental structural reform (including public enterprise and civil service reform, expenditure management and tax reform, strengthening of property rights, and improvements in governance). Directors also urged the authorities to provide adequate social safety nets and food security for vulnerable groups, particularly those affected by "Operation Murambatsvina" and HIV/AIDS. They also encouraged Zimbabwe to strengthen relations with the international community, including the Fund. Directors urged Zimbabwe to continue its efforts to resolve the remaining overdue financial obligations to the PRGF-ESF Trust and, at the last meeting, agreed to consider further these overdue financial obligations in six months.

At the March 8, 2006 meeting, Directors expressed a range of views regarding the restoration of Zimbabwe's voting and related rights, and terminating its ineligibility to use the Fund's general resources. There was insufficient support at the Board to restore Zimbabwe's voting and related rights. Furthermore, because of the sequential nature of the sanctions imposed under Article XXVI, Section 2, since the suspension of voting and related rights was not lifted by the Board, the Board was unable to consider the decision to terminate ineligibility to use the Fund's general resources.

At a subsequent meeting on February 23, 2007, the Board discussed the measures that Zimbabwe would need to take before the Board could consider again a decision to lift the suspension of voting and related rights. Following the discussion, the Board endorsed the following condition as the basis for reconsidering the decision to restore Zimbabwe's voting and related rights:

In order to demonstrate compliance with obligations under Article VIII, Section 5, Zimbabwe will be required to accurately report to the Fund its international reserves each month (with a lag of no more than one month) consecutively for a period of one-year. The data would be reported according to a template provided by Fund staff and verified each quarter through an external audit by an internationally-recognized auditing firm, applying International Standards on Auditing. The Reserve Bank of Zimbabwe will select the auditor through an open tender process using terms of reference agreed with Fund staff.

My recommendation to the Executive Board as to whether the Board should lift the existing sanctions would be based on the assessment by Fund staff regarding Zimbabwe meeting this condition. If Zimbabwe meets the specified condition, I would recommend to the Board that the remaining sanctions be lifted. A Board decision by a 70 percent majority of the total voting power would be required to restore Zimbabwe's voting and related rights.

Relations between Zimbabwe and the Fund remain at a critical juncture. I would urge you to act decisively and without delay on the recommendations of the Board, which would facilitate normalizing Zimbabwe's relations with the Fund.

Yours sincerely

/s/

Rodrigo de Rato

cc: Mr. Gakunu
Executive Director, IMF