April 4, 2007
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 07/16-3

10:10 a.m., February 23, 2007

3. Zimbabwe—2006 Article IV Consultation; Overdue Financial Obligations to the PRGF-ESF Trust; Restoration of Voting and Related Rights

Documents: EBS/07/15; EBS/07/16; SM/07/58 and Supplement 1 and Supplement 2; SM/07/62

Staff: Coorey, AFR; Fisher, PDR

Length: 2 hours, 44 minutes

Executive Board Attendance

T. Kato, Acting Chair

Executive Directors	**Alternate Executive Directors**
P. Gakunu (AE)	S. Kamara (AE)
L. Rutayisire (AF)	K. Assimaidou (AF)
J. Silva-Ruete (AG)	
R. Murray (AU)	
	J. Prader (BE)
E. Loyo (BR)	
H. Ge (CC)	
R. Guarnieri (CE)	
	P. Charleton (CO)
	S. Ladd (CO), Temporary
P. Duquesne (FF)	B. Dumont (FF)
	S. von Stenglin (GR)
A. Kishore (IN)	A. Herat (IN)
A. Sadun (IT)	
S. Kashiwagi (JA)	
A. Mirakhor (MD)	
A.S. Shaalan (MI)	
J. Kremers (NE)	
T. Saarenheimo (NO)	J. Sigurgeirsson (NO)
A. Mozhin (RU)	L. Palei (RU), Temporary
	A. Al Nassar (SA)
H. Phang (ST)	C. Sucharitakul (ST)
	A. Raczko (SZ)
	M. Kaplan (UA), Temporary
	J. Larsen (UK)

B. Esdar, Acting Secretary
T. Orav, Assistant

Also Present

IBRD: N. Kojo, P. Nicholas. African Department: A. Bio-Tchane, F. Caramazza, B.V. Christensen, J. Clausen, S. Coorey, R. Corker, J. Lizondo, S. Munoz, S. Tiwari. External Relations Department: A. Gaviria. Fiscal Affairs Department: T. Muzondo. Finance Department: M. Kuhn, J. Lin, P. Njoroge, R. Price, R. Sahay, S. Sriramachandran, Y. Sun-Wang, A. Tweedie. Legal Department: W. Bossu, H. Elizalde, T. Laryea, I. Mouysset, C. Ogada. Office of the Managing Director: P. Gerson. Policy Development and Review Department: P. Alonso-Gamo, M. Fisher. Secretary’s Department: A. Blazejewski, K. Meyers. Statistics Department: A. Galicia-Escotto. Senior Advisors to Executive Directors: R. Bannerji (IN), G. Cipollone (IT), G. Collange (FF), R. Gesami (AE), A. Guerra (CE), F. Haupt (GR), D. Kihara (JA), H. Mori (BR), K. Nauphal (MI), R. N'Sonde (AF), C. Roos Isaksson (NO), S. Rouai (MD), G. Samuel (BR), W. Schilperoort (NE), D. Sembene (AF), C. Senivongs (ST), J. Yoon (AU). Advisors to

Executive Directors: J. Agung (ST), J. Bergundhaugen (NO), A. Blazey (AU), M. Choueiri (MI), V. De la Barra (AG), C. Denk (GR), A. Eng (ST), J. Haegeli (SZ), M. Jakoby (BE), S. Kitamura (JA), J. Kwakye (MD), L. Lephoto (AE), A. Maciá (BR), C. Mira (CE), A. Prasad (IN), N. Riad (MI), G. Tesfamichael (AE), E. Valle (CE), T. Wezel (GR), A.Win (ST), L. Zhong (CC).

3. ZIMBABWE—2006 ARTICLE IV CONSULTATION; OVERDUE FINANCIAL OBLIGATIONS TO THE PRGF-ESF TRUST; RESTORATION OF VOTING AND RELATED RIGHTS

Mr. Gakunu and Mr. Mafararikwa submitted the following statement:

Introduction

The Zimbabwean authorities are thankful for the continued policy advice from the Fund and would like to thank Management and staff for the constructive engagement and relentless effort in finding the best way forward on the issue of Zimbabwe's voting and related rights in the Fund. They remain disappointed that their voting rights in the Fund have not been restored, yet the country is no longer in breach of any financial obligations to the GRA. On reserve reporting, Zimbabwe was using an outdated template, and with assistance from the staff, they migrated to a new template, with reporting beginning in October 2006. Zimbabwe has not breached any obligations related to reserve reporting and there is no reason to expect that such obligations will be breached in the future. The authorities view the proposed conditionality on reserves reporting as another attempt to delay the restoration of their voting rights, especially given that there is no guarantee that the measure will garner the necessary 70 percent majority after the one year. The authorities look forward to the immediate restoration of their voting rights so that the spirit of trust with the Fund is built and focused on helping Zimbabwe restore economic stability and growth.

Recent Economic Developments

On the economy, Zimbabwe has experienced real GDP decline and high inflation since 1999, contributing to worsening of living standards of the general population. However, the true measure of economic decline is debatable given the large informal sector and sizable remittances from abroad. The authorities broadly share staff's analysis and conclusions presented in the background staff papers that summarize the economic and social situation facing the country and recommend the need for implementation of a comprehensive package of reforms to stabilize the economy. Past efforts to stabilize the economy have not been successful, reflecting among other constraints, policy shortcomings and international isolation. Against this background, and for the first time since the crisis began, the authorities have just embarked on a comprehensive package of reforms under a "social contract," of which some measures have already been implemented while others are being negotiated.

The challenges arising from implementing an appropriate macroeconomic framework for successful stabilization are enormous, underscoring the need for technical assistance. As staff observe, those countries that were successful in stabilizing their economies without balance of payments support did so with the benefit of technical assistance from the Fund. The authorities urge the Executive Board to lift the ban on technical assistance to help them implement their comprehensive set of reforms. They regret the overdue obligations to the PRGF-ESF Trust and remain committed to make payments and eliminate them once the balance of payments allows.

Restoration of Voting Rights

Upon clearing arrears to the GRA in early 2006, Zimbabwe intended to eliminate the breach of those financial obligations that gave rise to the threat of compulsory withdrawal of membership and suspension of voting rights, thereby removing a major distraction to policy formulation and implementation and engagement with the international financial community. It is acknowledged in the background paper that in addressing Zimbabwe's case of clearing all arrears to the GRA, the Fund is facing circumstances that had not been previously confronted and proposes an approach which would be applied to future cases in similar circumstances and would also avoid creating a precedent for more onerous conditions. This confirms the view that Zimbabwe's case is being used to amend a major policy without the benefit of a thorough Board discussion or Review of the Arrears Strategy. Perhaps such a review is not necessary given that, as was argued by staff and management in the discussion of March 2006, the case of countries that clear their protracted arrears to the Fund was not anticipated to create any problems; once such basis for sanctions is removed by clearing arrears, then sanctions would be lifted. Failure by the Fund to restore Zimbabwe's voting rights upon clearance of GRA arrears therefore created the perception that the Fund was being political. This undermined the authorities' trust that the Fund is an independent cooperative institution that does not yield to political influences by its most powerful stakeholders. Therefore, immediate restoration of Zimbabwe's voting rights, will help build trust and strengthen cooperation while earning the Fund its good reputation in Zimbabwe.

Reporting of International Reserves

Regarding the reporting of reserves, the Zimbabwean authorities understand the importance of reporting reserves and other economic data to the Fund, just like any other member to facilitate the Fund do its surveillance more effectively. The discrepancies in the reporting arose because the authorities were using an old template of the Fund, a problem that was not detected by previous Fund missions. The discovery was made by staff when the Board questioned the source of funds used by Zimbabwe to clear GRA arrears. The issue was then to help the authorities migrate to the new template, which was done with assistance from the staff. The new template has been applied to reporting of reserves beginning October 2006. The authorities believe therefore that reporting of reserves is their duty as a member which should not come in the form of sanctions or conditionality.

The Social Contract

The authorities have fully acknowledged that drastic action is needed to arrest economic decline and for the first time since the crisis began, they have embraced the importance of a comprehensive package of fiscal, monetary, exchange, and structural policy measures aimed at deregulating and stabilizing the economy. Their approach of a "social contract" has been necessitated by the demand for building consensus around the reforms, given the deterioration in confidence and polarization of society. The package of measures has been endorsed by the Head of State and negotiations are underway with various stakeholders. The measures involve transfer of quasi-fiscal activities to the budget, elimination of subsidies or target them where necessary, deregulation of prices and imposition of a hard budget constraint on public enterprise, expediting public enterprise reform, pursuing a tight fiscal policy, establishing a strong monetary anchor, maintaining positive real interest rates, liberalizing domestic and external trade and the exchange system, including the removal of multiple currency practices. In this regard, the authorities agree with staff and are implementing recommendations in the staff report.

Current Policy Actions

While catalyzing negotiations for the social contract, the Government is already taking bold measures which enhance the credibility of their policy intentions and allow it to assume leadership of the process. Under this strategy, both the 2007 budget and the Monetary Policy statement of January 2007 announced the transfer of new quasi-fiscal activities to the budget while creating a new entity to oversea the completion of existing quasi-fiscal activities whose finalization will contribute to growth of the economy. Overall, quasi-fiscal activities are being drastically reduced by: eliminating subsidies; removing price controls; and increasing prices and tariffs of public enterprises. In the last two weeks, action has been taken to eliminate the subsidy on staple food, maize, and wheat, translating into a 9,500 percent increase in the price of staple foods. This is the most sensitive area, which was also the focus of rent seeking and corrupt activities. This bold move will allow the government to move with speed in other areas such as elimination of subsidies on fuel, electricity, and others and these actions are expected in the next weeks. The authorities have indicated that they will provide safety nets for the very poor and needy.

While this year's budget contains a sizable increase in capital expenditure, government will refrain from starting new projects. Priority will be given to accommodating essential projects from the quasi-fiscal activities being transferred from the central bank. This will allow the central bank to focus on establishing a monetary anchor and pursue a tight monetary policy with a view to reducing inflation to 350-400 percent by December 2007. Strong supervision has helped to boost the resilience of the banking system. The authorities are fully aware of the vulnerabilities to the banking system arising from further decline in the economy and a high inflationary environment. This year's agricultural season is still evolving, supply of inputs has improved and the rainfall so far is reasonable. A good harvest will help to boost GDP and cool inflationary pressures. Government is expediting the issuance of 99-year leases to provide security of tenure to farmers and to allow the banks to lend to the agricultural sector.

On the foreign exchange market, the inflow of remittances has been liberalized, with recipients allowed to receive their proceeds in US dollars and convert at a time and rate of their convenience. This might create other challenges, and that is why we underscore the importance of technical assistance, which we repeatedly requested the Board to allow Zimbabwe to benefit from. Our view has always been that a blanket suspension of technical assistance should not be part of the Strengthened Arrears Strategy of the Fund. Instead, Management should be given the discretion to provide technical assistance where it is needed and utilized well. The liberalization of remittances, nevertheless, will allow the economy to benefit from remittances from about four million Zimbabweans in the diaspora and could act as balance of payments support, FDI, as well as a safety net during the painful adjustment period ahead.

Conclusion

Zimbabwe is in critical need of economic stabilization and the Fund, as the only international institution with such expertise, needs to play a lead agency role, at least initially. The distrust that has emerged between Zimbabwe and the Fund has not only further isolated Zimbabwe but also dented the reputation of the Fund in Zimbabwe and abroad, going by the divisions in the Board on the matter. We believe the Fund, as a cooperative institution, should reach out to a member in need by immediately restoring Zimbabwe's voting rights, lift the ban on technical assistance, and remain constructively engaged to encourage the country to bite the bullet.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

Over the last year, poor economic policies in Zimbabwe have continued and economic conditions have further deteriorated. Real GDP has contracted by 5 percent, inflation has accelerated to four-digit levels, and fiscal and quasi-fiscal deficits further widened. Under the current economic policies, the dismal performance of the Zimbabwean economy will certainly continue. Therefore, we agree with staff that, in order to reverse this process, the authorities need to urgently implement a comprehensive stabilization package aimed at arresting hyperinflation and restoring a normal functioning of the economy. We broadly agree with the priority measures proposed by staff in this regard. Their implementation would be in the best interest of Zimbabwe.

In the current situation of an acute economic crisis, maintenance of a dialogue between the Fund and the authorities is of utmost importance. Unfortunately, as we could conclude from the staff report, the relations between the Fund and the Zimbabwean authorities have further eroded as a result of the unfortunate outcome of the March 2006 review. Since then, Zimbabwe's relations with the Fund have rapidly deteriorated. It is not very surprising, as the positions of those in Zimbabwe, who had regarded the Fund as a cooperative institution, must have been undermined.

A proper resolution of this case is important not only for Zimbabwe, but for the Fund itself. It is a test for the Fund's ability to operate as a rules-based institution, whose decisions are consistent with the principles of equal treatment.

Despite the full settlement of the Zimbabwean arrears to the General Resources Account, the Executive Board upheld sanctions against Zimbabwe. This was the first precedent when the member's request to terminate the suspension of the voting rights was denied by the Fund and, at the same time, the Fund was unable to formulate further actions that the member had to undertake in order for the sanctions to be lifted. Rules K-4 and K-7 stipulate that the Fund should present its conditions in a written report to the authorities. This has not been done for almost a year.

We are not satisfied with the proposed decision. Sanctions were imposed on the grounds of the GRA arrears. Zimbabwe has cleared all its arrears to the GRA and now has no outstanding obligations to the GRA. Therefore, Zimbabwe is not in a position to breach its obligations in this respect in the future. We see these considerations as the only basis on which decisions regarding the lifting of sanctions could be made. We believe that any further prolongation of sanctions for another year on the pretext of avoiding potential breach of the member's reporting obligations under Article VIII, Section 5, would be unfounded. We all know about actual, not potential, misreporting cases and poor quality of statistics in many Fund members, which prevent them from providing accurate information to the Fund. However, in most cases, the Fund has addressed such problems by providing technical assistance. Termination of voting rights is not a solution to reporting problems and we are not aware of the precedents of that kind in the Fund's history. Therefore, we do not believe that the principle of uniformity of treatment is being applied in the case of Zimbabwe. We also think that we could create undesirable precedent, as the Fund, in fact, imposes new sanctions on a member just because of the apprehensions of the potential violation of its obligations in the future. Therefore, we continue to support the unconditional restoration of Zimbabwe's voting rights.

As for the overdue financial obligations to the PRGF-ESF Trust, we note that there have been no positive developments in resolving this problem over the last year. After the decision of March 8, 2006, the authorities' cooperation with the Fund has deteriorated, as well as their payments record. Arrears have increased, from SDR 83 million to SDR 86 million. We agree with staff that, according to the Fund's rules, the remedial measures should remain in place. We support the proposed decision on this issue.

Mr. Murray and Mr. Yoon submitted the following statement:

We thank staff for the excellent report for the 2006 Article IV consultation on Zimbabwe, which is frank and constructive, and Mr. Gakunu and Mr. Mafararikwa for their statement. We share staff's concern on a deepening crisis in the Zimbabwean economy. Output has fallen substantially with skyrocketing inflation. Staff noted that twelve-month official inflation accelerated to 1,594 percent in January, yet true inflation may be around 2,000 percent. Staff estimate inflation could rise to 5,200 percent by the end of the year. Social indicators have also deteriorated, especially rising poverty and malnutrition. We agree with staff that poor and unpredictable economic policies and weak governance are the main causes of the deteriorating economic and social situation. Rising and persistent quasi-fiscal deficits have fueled accelerating inflation; intensifying and distorting price controls, including exchange rates in particular, and weak governance resulted in collapsed investor confidence and falling output; and high inflation and widespread government intervention led to a drying up of financial intermediation.

We are greatly concerned that the economic crisis is likely to deepen unless policies change. Like staff, we urge the authorities to implement without delay a comprehensive stabilization package. It is disappointing, however, that in the recent monetary policy statement Zimbabwe did not take the steps recommended by staff. As staff have pointed out, the policy framework in the monetary policy statement lacks credibility and the attempts to freeze prices and wages are likely to be unsuccessful and not address the fundamental causes of the economic crisis. Substantial fiscal tightening, together with transparent transfer of quasi-fiscal activities to the government budget, should be undertaken without delay in order to rein in rampant inflation. As evidenced in many stabilization programs, the exchange rate should be unified upfront with removal of exchange restrictions on current international transactions, and extensive price controls should be lifted so as to restore “price” function. These immediate policies should be complemented by comprehensive structural reform over the medium term, including fiscal and public sector reform, land reform, and improving governance, which will be essential in consolidating macroeconomic stability and helping sustain growth.

We regret the apparent lack of commitment and political will to address the crisis now engulfing Zimbabwe, which will exacerbate the situation and impose a heavy toll on most of the Zimbabwean population. In this regard, we again urge the authorities to embark on an economic stabilization package immediately and to take necessary reforms so as to restore investor confidence and strengthen cooperation with the international community.

Restoration of Voting and Related Rights

We acknowledge the reasons outlined by staff for putting forward their proposal to reinstate Zimbabwe’s voting rights based on conditions relating to international reserves reporting. We also recognize that rejection of the staff’s proposal may lead to a significant delay in the restoration of Zimbabwe’s voting rights, since differing views among Executive Directors are likely to stall the process for reaching a consensus needed to establish a new set of conditions.

On the other hand, we are disappointed by the staff's proposal as not presenting a sufficiently high enough hurdle for Zimbabwe to reinstate its voting rights. Therefore, we oppose the approval of the Managing Director's letter and urge staff to require Zimbabwe to take action to rectify its other breaches of the Articles. We are also concerned that this less onerous proposal poses a risk to the credibility of the Fund.

Zimbabwe has been in breach of obligations under the Articles, maintaining restrictions on current transactions and engaging in multiple currency practices without approval by the Fund. The multiple currency practices and exchange restrictions on current transactions are a significant source of distortion in the Zimbabwean economy and are also a major contributor to the fiscal deficit. These are key areas identified by staff for fundamental policy change in order to stabilize the Zimbabwean economy. In this regard, we believe that it would be more appropriate for the Fund to require these breaches to be rectified, which would involve substantive policy change to restore macroeconomic stability. In reinstating its voting rights, Zimbabwe should be required, at a minimum, to take actions to demonstrate progress under an appropriate stabilization policy package, in order to eliminate on a sustainable basis the multiple currency practices and to address restrictions on the making of transfers and payments for current international transactions, in addition to the requirement on reserve reporting as proposed by staff.

In relation to this decision, we would like to acknowledge that this is not a unanimous view, but reflects a majority view of our constituency.

Overdue Financial Obligations to the PRGF-ESF Trust

We regretfully note that Zimbabwe's cooperation on payments of its arrears to the PRGF-ESF Trust has worsened markedly since the previous review. Therefore, we support the proposed decision that the remedial measures taken by the Board to address Zimbabwe's PRGF-ESF arrears remain in place.

Ms. Lundsager and Mr. Kaplan submitted the following statement:

We thank the staff for an excellent staff report, selected issues, and report on Overdue Financial Obligations to the PRGF-ESF Trust. We appreciate the candor of the documents, and broadly agree with the staff's recommendations.

The authorities should consider themselves fortunate that, in the context of surveillance, the staff has done them a great service by presenting data on the true fiscal costs to Zimbabwe of its ruinous economic policies, by providing helpful information on cross-country experience in recovering from hyperinflation, and by articulating a coherent set of measures that could be enacted today to begin to reverse Zimbabwe's destructive slide. It is clear that the staff has made every effort to offer the authorities a road map to recovery from their self-inflicted wounds.

Equally clear is that the staff's efforts have come to naught because of a fundamental lack of political will. Zimbabwe's authorities have zero credibility. The Central Bank Governor and then-Minister of Finance made commitments before this Board at the 2006 Article IV consultation, including for the gradual repayment of arrears to the PRGF Trust. Those commitments have not been realized. Indeed, as the Report on Overdue Financial Obligations makes clear, policy performance and PRGF repayments only worsened over the course of 2006. The transfer of quasi-fiscal activities from the RBZ to the Ministry of Finance, a necessary move that could have signaled a desire for change, is instead a hollow gesture in the absence of credible financing and expenditure cuts. With due regard for Messrs. Gakunu and Mafararikwa, with respect to their statement on Zimbabwe's latest policy intentions, we follow the staff's conclusion that "the policy framework in the Monetary Policy Statement lacks credibility in the absence of decisive and upfront action to lower the fiscal deficit, including quasi-fiscal activity of the RBZ, and liberalize prices, including the exchange rate."

We agree with the proposed decision in EBS/07/15 to maintain the declaration of noncooperation, the suspension of technical assistance, and the removal of Zimbabwe from the list of PRGF-ESF eligible countries.

Voting Rights

The Board has the right to ensure Zimbabwe's sustained compliance with its obligations under the IMF Articles, including Article VIII, Sections (2), (3), and (5). The staff suggests that the Board adopt a timid proposal, focused largely on accurate reserves reporting, "to avoid creating a precedent for more onerous conditions that the Fund might be unwilling to apply in future cases." We see no such danger. Indeed, in previous instances of reinstatement of members' forfeited voting rights, such members had staff monitored programs in place. In the current case, the staff does not even require Zimbabwe's compliance with the IMF Articles, much less to meet a higher standard of economic policy cooperation.

We do not believe that the IMF Articles require the Board to apply identical terms and conditions to the reinstatement of voting rights in all cases. Where do the Articles deprive the Board of the ability to consider the degree of a member's cooperation with the Fund? Through self-destructive policies, the Zimbabwean authorities have delivered to the people of Zimbabwe the lowest life expectancy on earth. Throughout the staff report we read of the authorities' ability to act, but their abdication of responsibility. How can the Board welcome Zimbabwe back to the Fund while disregarding the Government of Zimbabwe's destructive economic policies? How can the Board ignore the impact of Zimbabwe's arrears to the PRGF-ESF Trust on other low-income members, since the creditors to the PRGF are drawing down the PRGF Reserve Account as collateral? Our role as the Trustees of the PRGF-ESF Trust argues for our taking action.

A credible alternative proposal is available. Zimbabwe's sustained take up of the staff's recommended policy package for economic recovery would effectively meet Zimbabwe's obligations under Article VIII, Sections (2) and (3), specifically the requirement to unify the exchange rate and eliminate exchange restrictions with respect to the making of payment and transfers for current international transactions. Strong fiscal adjustment will be necessary to underpin these reforms, as the staff has also asserted. These reforms will start Zimbabwe on the path to recovery, and the staff has provided ample evidence to demonstrate that the authorities can enact these measures now. With these preconditions in place, we are also confident that management's strong exhortation to Zimbabwe to show solidarity with other low-income members by making progress on repayment of PRGF-ESF Trust arrears will also bear fruit.

We therefore are unable to support the proposed decision in EBS/07/16, and would like to be recorded as voting no. We would like to work with Directors to craft an alternative that can command the consensus of the Board.

Ms. Phang and Mr. Win submitted the following statement:

We welcome the follow-up discussion on the restoration of Zimbabwe's voting and related rights in the Fund, and thank staff for an informative set of papers. We also thank Mr. Gakunu for his statement on recent developments in Zimbabwe.

Restoration of Voting Rights

We are of the view that Zimbabwe's voting rights in the Fund should be restored immediately and unconditionally and the ineligibility to use the Fund's general resources be terminated. This is because the basis for the suspension of voting rights (the arrears to the GRA) no longer exists and for all intent and purposes Zimbabwe is not in any breach of its obligations to the Fund. In this regard, we would like to ask the staff to confirm our understanding that there are currently other Fund members who, like Zimbabwe, do not fully comply with the data reporting on international reserves but still receive technical assistance from the Fund and no action has been taken against them. We believe that it is extremely important to exercise evenhandedness and not to overextend the use of discretion in the decision to restore voting rights to Zimbabwe as this has important implications on the Fund's legitimacy and governance. We believe that it is extremely important to distinguish the true rationale for the action taken on the suspension of voting rights from the need to coerce members to undertake a reform program.

There is an urgent need for a comprehensive policy package to stabilize the unsustainable economic situation.

We are deeply concerned that the Zimbabwean economic situation has deteriorated further in 2006, as output continued to contract, inflation soared to a four-digit level, the fiscal deficit widened, and the foreign exchange shortage remained acute. Meanwhile, the social, poverty, and HIV/AIDS conditions also deteriorated. In light of these developments, we concur with staff that the risks for a downward spiral of the economy are imminent and that a comprehensive package of macroeconomic and structural policies is urgently needed to stabilize the economy. Moreover, the implementation of such a policy package could provide an important signal to donors and the international community, including the Fund, of the authorities' efforts to pull Zimbabwe out of this unsustainable economic environment.

The current fiscal picture looks bleak unless efforts are made to arrest the situation. While we note the authorities' efforts to use fiscal policy to reduce output contraction, such a policy could more likely at present lead to the wasteful use of fiscal resources in the context of an extremely high inflation environment. While we share staff's view that, in the stabilization scenario, the adjusted primary fiscal deficit in 2007 should be limited to 15.5 percent with a view to help pull inflation down to about 450-500 percent in 2007, we empathize with the authorities that this will not be an easy task especially as they need to also prioritize spending to ensure food security, provide targeted social safety net, support health infrastructure, and address the need of those adversely affected by 'Operation Murambatsvina.'

On monetary policy, we welcome the recent positive developments, such as the decision to transfer all previous quasi-fiscal activities (QFAs) to the budget and to stop engaging in QFAs by the Reserve Bank of Zimbabwe (RBZ). Nevertheless, the financial picture of the RBZ itself is unsustainable as depicted clearly on page 8 of the staff report. The interest costs (flows) of open market operations are very substantial as a percent of GDP. We therefore underscore an urgent need to adopt a credible monetary anchor to reduce inflation and inflation expectations going forward. Efforts toward unifying the exchange rate should be part of a comprehensive policy package on this front. While bank supervision has been strengthened, the shrinkage of banks' balance sheets in real terms will eventually decimate the ability of banks to serve as an effective financial intermediary. Meanwhile, the performance of the stock market, while favorable, has reflected the replacement costs of businesses and not the long-term profitability of businesses that would be conducive to long-term capital market development.

Overdue Financial Obligations to the PRGF-ESF Trust

We note that Zimbabwe's payments of its arrears to the PRGF-ESF Trust have been minimal since the last review, resulting in further increase of arrears. Thus we support the proposed decision to hold the next review of Zimbabwe's arrears to the PRGF-ESF Trust within six months. However, the suspension of technical assistance will not help improve the country's ability to pay its arrears, and we feel that the proposal (EBS/07/15) to keep the imposed remedial measures in place, including the suspension of technical assistance, would in fact cause more harm than good to the country and its economy.

With these remarks, we wish the authorities success in addressing their daunting challenges.

Mr. Mirakhor submitted the following statement:

Like Ms. Phang and Mr. Win, our Chair supports the restoration of Zimbabwe's voting and related rights and the lifting of the declaration of ineligibility to use the general resources of the Fund since, as Mr. Gakunu and Mr. Mafararikwa underscore in their statement, the breach of obligations that led to the sanction, i.e. the arrears to the GRA, was remedied one year ago. Stemming the protracted deterioration of Zimbabwe's economic conditions requires urgent adoption and implementation of a comprehensive package of macroeconomic and reform policies along the lines suggested in the staff report to stabilize the economy in the near term and place it on a path of sustainable growth over the medium- to long-term horizon. Because the required policies would entail short-term hardships, political commitment and domestic consensus for the implementation of the adjustment and reform policies will be necessary. An early reengagement with the international community is also crucial. A strong indication of commitment to a comprehensive adjustment and reform effort will send a needed signal to donors and thereby open the way for reaching understandings on settling outstanding financial obligations and provision of financial assistance and debt relief. Mr. Gakunu and Mr. Mafararikwa provide strong assurances in this regard. The bold action taken by the authorities to eliminate the subsidy on staple food, maize, and wheat attests to their resolve.

The staff report details a comprehensive set of policies necessary to stabilize the economy, although clearer prioritization and sequencing would have been helpful. Rightly, the policies center on fiscal consolidation, with the wage bill, capital expenditure, and quasi-fiscal activities (QFAs) bearing the brunt of expenditure cuts to enable an increase in spending on food imports, health, and education. The Reserve Bank of Zimbabwe’s QFAs need to be fully incorporated in the budget to enhance transparency. Well-targeted social safety nets will be required to protect groups particularly vulnerable to the fiscal adjustment.

Fiscal tightening will provide critical support to reining in high inflation. This should be complemented by a strong nominal anchor, preferably a monetary rather than an exchange rate anchor, given the paucity of reserves. Obviously, this disinflation strategy (elaborated by staff in the Selected Issues paper) is a conventional, short-sharp approach, which could have significant short-term economic and social costs. We wonder if staff have considered the “Social Contract” approach, mentioned by Mr. Gakunu and Mr. Mafararikwa, involving a mutually-negotiated income-price freeze by government, labor, and employers. This approach has been used successfully in some hyperinflation cases, although the freeze has to be in place only for a limited period of time, pending full implementation of the necessary policy adjustments. This seems to be the intended purpose of the National Incomes and Pricing Commission Bill, which the authorities assure will not be used as an instrument of price control, but to manage the transition to full price deregulation.

There is merit in moving to a more flexible exchange rate regime to reduce distortions in the foreign exchange market, bolster supply in the official system, and reduce the parallel market premium. Other prices, including utility tariffs, also need to be deregulated to reduce cost-price distortions to bolster supplies and reduce fiscal contingent liabilities. While helping to boost production and supplies, liberalization of prices will also reduce incentives for rent seeking and corruption.

The financial system seems to have been reeling under the current macroeconomic policy burden, shrinking in real terms and contributing minimally to private financial intermediation. As Chapter II of the selected issues paper elaborates, only significant changes in the policy environment will improve the banking sector's outlook and enable it to provide needed support to private sector economic activity.

Comprehensive structural reforms will be also required to support sustained economic growth over the medium to long term. As detailed in the staff report in paragraph 22, key reforms include those geared to improving public sector efficiency, enhancing transparency in public financial management, strengthening protection of property rights and investments, and opening up the economy to competition.

Improving the medium-term prospects will require fundamental policy changes, as underscored above, to strengthen economic performance and regain donor and investor confidence. The external debt profile, based on unchanged policies, is clearly unsustainable and vulnerable to shocks, especially depreciation and export decline, while over half of the external debt is in arrears (Appendix). In addition to improved policies, strong debt management, supported by external financial assistance, will be important in placing the debt on a long-term sustainable path.

The staff report does not directly address capacity constraints that may hinder the implementation of the required policies, but the authorities stress the urgency for the provision of technical assistance. Noting that the ban on technical assistance will be lifted at some point, it is encouraging to learn of staff's readiness to "intensify policy discussions" in response to any positive policy signals from the authorities.

The donor community's readiness to extend substantial external resources in support of the stabilization program would be crucial for its success. Confidence factors are indeed essential, and the role of the international community is paramount. While the selected issues paper indicates that several countries with hyperinflation managed to stabilize the economy without an increase in official foreign financing, Zimbabwe’s case is very different in that the country has been cut off from official and private external assistance for a prolonged period. Moreover, technical assistance, including from the Fund, was also suspended. A positive signal from the donor community at an early stage of the stabilization program could help instill a degree of confidence and unlock the crucially-needed private financing.

Mr. Kremers submitted the following statement:

The economic situation in Zimbabwe is of great concern, especially as it is driven by devastating macroeconomic policies. I endorse staff’s analysis of the situation and agree with the policy recommendations. A fundamental change in policies is needed to reverse the economic contraction, skyrocketing inflation, and worsening living standards.

Staff rightly note that the main elements for macroeconomic stabilization are: a transfer of quasi-fiscal activities to the budget, introduction of a stable fiscal policy and a strong monetary anchor as well as of an appropriate exchange regime. In their statement, Mr. Gakunu and Mr. Mafararikwa note that the authorities broadly share staff’s analysis and that the authorities have just embarked on a comprehensive package of reform under a social contract. Could staff comment on the contents and the extent to which it is expected to help a reversal of current economic decline?

In addition, the liquidity risks that endanger the shrinking banking sector are a matter of great concern. Staff state in the selected issues paper that it is arguable whether the banking sector continues to be of systemic importance given the shrinkage of banks in real terms. Nevertheless, this does not justify neglect as an almost nonexistent financial sector, as this is certainly not a good starting point for reversal of economic conditions. To avoid a new banking crisis, a macro package that will help to address the high inflation that is undermining the banking sector should be complemented by targeted measures for the financial sector, such as a removal of nonprudential restrictions on banks’ liquidity management, including compulsory purchase of any type of asset. Restoring health to the process of financial sector development will be key to restarting and subsequently sustaining economic recovery.

As to the restoration of voting and related rights, I thank management and staff for the proposal for a way forward. The proposal is broadly consistent with the approach that I took in my statement to the Board of March 8, 2006, focusing on basic central bank transparency and reporting requirements as anchored under Article VIII, Section 5. Noncompliance with these requirements last year in my view was a justified grounds for not restoring Zimbabwe's voting rights at that time, taking into account both the direct link to the issue of clearance of arrears and the source of payments to the Fund, as well as the broader consideration that transparency of the central bank accounts reflects the integrity of the first financial contact point between the Fund and its member.

Against this background I support today's proposal. Having said that, it is clear from some of today's preliminary statement that it will remain uncertain whether compliance with obligations under Article VIII, Section 5, at a future date will suffice to generate the required 70 percent majority in the Board to restore Zimbabwe's voting and related rights. More broadly, the circumstances in Zimbabwe and its relations with the Fund have been turbulent in the past and may remain unpredictable in the period ahead. For both of these reasons, it should be made clear to the authorities that compliance with obligations under Article VIII, Section 5, will be necessary but may not be sufficient when the Board at a future point in time makes an overall assessment taking into account the legal context and all circumstances relevant at that time.

I hope that the Board will be able to converge on the proposal put forward by management which, depending on one's perspective, may not be ideal, but which I believe strikes a reasonable balance of the various considerations that may be brought to bear on this difficult constellation. As in our discussion last year, I would not support making sound macroeconomic policy—however crucial for Zimbabwe's people and economic outlook—a condition for restoration of voting and other rights, given that this is of a different order and in my view belongs in the realm of surveillance and possibly (hopefully) a future program relationship.

Mr. Alazzaz submitted the following statement:

I remain of the view that Zimbabwe's ineligibility to use the Fund's general resources should be terminated and that its voting and related rights in the Fund should be immediately restored. The failure of the Board to do so last year following Zimbabwe's clearance of its arrears to the General Resources Account has not been in the interest of either Zimbabwe or the

Fund for the reasons noted in the statement of Mr. Mozhin and Mr. Tolstikov. Accordingly, I hope we could reach a cooperative solution on this issue today in order to focus our attention on helping Zimbabwe address its difficult economic situation and limit any reputational damage to the Fund.

As noted in the staff report, output in Zimbabwe has been shrinking, poverty has been increasing, and inflation has been accelerating sharply. Accordingly, it is clear that immediate and substantive action needs to be taken to put the economy back on track. To this end, timely implementation of a comprehensive stabilization and reform program along the lines recommended by the staff is essential. In this regard, the elimination of the maize subsidy and the reporting of official reserves according to the new template provided by staff are steps in the right direction. I also welcome the commitment in the letter of H.E. Dr. Gono, Governor of the Reserve Bank of Zimbabwe to implement an important set of reforms over the next few months. However, in view of the gravity of the economic situation, full implementation of these reforms and advancing the start of phase 2 are needed. To this end, it is important for the Fund to provide Zimbabwe the technical assistance it needs to implement its reforms.

Finally, Zimbabwe's outstanding arrears to the PRGF-ESF Trust remain a concern. In this regard, I urge the authorities to strengthen their efforts to eliminate those arrears in a timely manner. They are also encouraged to regularize the arrears relating to all other external creditors.

Mr. Raczko and Mr. Haegeli submitted the following statement:

Zimbabwe is in a very difficult situation both in its relations with the Fund and with regard to its economic outlook. Each has to be treated independently and according to Fund policies. First, in its relations with the Fund, we endorse the staff proposal of the restoration of voting rights conditional on Zimbabwe's adequate reporting of foreign exchange reserves. Regarding the PRGF-ESF Trust arrears, we regret that Zimbabwe keeps accumulating overdue obligations and therefore support the decision to continue with the application of the current remedial measures. Second, on the recent economic developments, we are concerned about the rapid deterioration of the situation. As suggested by staff, the authorities should quickly and forcefully implement a comprehensive reform package to achieve macroeconomic stabilization.

Voting Rights

We are concerned that, for almost one year, the Fund has been unable to state the further actions required for the restoration of Zimbabwe's voting rights. This puts the Fund's credibility at stake. In the last discussion, our Chair was in favor of the staff's proposal to restore Zimbabwe's voting rights given that the authorities were back in compliance with their financial obligations under the Articles of Agreements. For the sake of a compromise, we support the new proposal put forward by staff. The proposal to lift sanctions conditional on Zimbabwe's adequate and audited reporting of international reserves is a meaningful way to deal with our concerns related to the sources of financing used to clear the GRA arrears. We invite the authorities to use the provided templates in their own interest as they improve transparency.

Overdue Financial Obligations

We regret that Zimbabwe keeps on accumulating arrears to the PRGF-ESF Trust and therefore support the decision to continue with the application of the current remedial measures. We note that the authorities' cooperation with the Fund has worsened and thus see no grounds for being more accommodative than at the last Board meeting.

The Economic Situation

As the economic crisis deepens, we agree with staff that Zimbabwe needs to swiftly implement a comprehensive package of short-term macroeconomic stabilization measures. As shown in the selected issues paper, most successful stabilization episodes have resulted from a comprehensive package. However, we wonder why staff's comparator countries only include two African countries. In this context, we would appreciate staff comments on the influence Zimbabwe's economic specificities would have on the design, the timing, and the extent of a stabilization package.

To put the economy back on track, restoring proper fiscal and monetary policies is crucial. The practice of financing the quasi-fiscal losses of the central bank through money creation and issuance of central bank securities must be eliminated to stop hyperinflation. While we welcome the authorities' decision to eliminate these quasi-fiscal activities, we are concerned that their inclusion in the government budget might not adequately reflect their extent. Transparency and clear offsetting of budget transfers are key for a credible solution. Further measures must include the liberalization of the exchange regime through the unification of the tender rate for foreign exchange and removal of the restrictions on current international payments and transfers. Finally, we urge the authorities to forcefully tighten fiscal policy and to adopt strong corrective measures in their planned 2007 national budget.

There is an urgent need to also introduce drastic measures on the structural side to restore investor's confidence and provide the right incentives for private sector agents. Transparency and market signals are key drivers to put a country back on track and to set it on a sustainable growth path. Consequently, structural measures should include the strengthening of governance, particularly the re-establishment of property rights, price liberalization, and public enterprises reform. However, the authorities' plan to freeze prices, wages, interest rates as well as fees, tariffs, and charges for a four-month period starting on March 1, stands in sharp contrast to the suggested measures. In this context, we would also welcome staff's comments on the establishment of an "institutional framework" to handle the marketing of platinum and diamonds, as this seems to be another sign of increasing government interference in the economy.

Regional Implications

Assessing the regional implications of the difficult situation in Zimbabwe is an area of core competency and of comparative advantage of the Fund. We welcome the information given in paragraph 3, but we would appreciate more comments from staff about the macroeconomic impact, especially of labor movements and financial flows, on neighboring countries such as Botswana, Mozambique, Zambia, and South Africa. In particular, we would be interested in knowing to what extent these countries are affected by the economic instability.

Mr. Charleton and Mr. Ladd submitted the following statement:

We thank the staff for a candid report and for selected issues papers that are apt and timely, given the current issues. As Ms. Lundsager and Mr. Kaplan note, the staff's patience and diligence have been disproportionate to the responsiveness of the member.

On the Article IV findings:

It is clear from the Article IV consultation that Zimbabwe has not taken measures to halt the deterioration of their economy, a deterioration with serious consequences for their people and their neighbors. In fact, the staff report establishes that by all relevant objective measures, the situation is worse than at the last review.

We agree with the staff and Messrs. Murray and Yoon that recent government pronouncements calling for yet another "social contract" lack credibility. To work, social contracts require the state to uphold their commitments, including a respect of basic economic governance. Previous staff appraisals and summings up have been sufficiently clear on the subject and require no repetition here. We support the staff's recommended stabilization measures and encourage the authorities to implement them forthwith.

On the overdue financial obligations:

We note that Zimbabwe's arrears to the PRGF-ESF Trust have increased by SDR 3.2 million since the last review. This Chair regrets this further deterioration of Zimbabwe's cooperation with the Fund, and fully supports the maintenance of the remedial measures to address the PRGF-ESF arrears.

On voting and related rights:

Since March 8, 2006, the Zimbabwean authorities have been waiting for the Fund to state the further actions required for terminating the suspension of their voting rights. The paper on the restoration of voting rights points out the novelty of the situation: a member under sanction has cleared their arrears, but there is a reasonable basis to conclude that they are in breach of other obligations under the Articles.

EBS/07/16 points out the measures needed for Zimbabwe to properly report its foreign exchange reserves, bringing it into demonstrable compliance with Article VIII, Section 5. In addition, the Article IV staff report demonstrates that Zimbabwe's exchange rate arrangement is inconsistent with Article VIII Sections 2(a) and 3, to which the member subscribed in 1995. We see little scope for improved conformity with the Articles and better economic outcomes until the Zimbabwean administration acknowledges that these problems are the result of conscious policy decisions, and accepts full and sole responsibility for the consequences.

Asking only that Zimbabwe report accurately and verifiably on its foreign exchange reserves for a year is insufficient, given their deteriorating cooperation with the Fund. We do not accept other Chairs' claim that this departs from the principle of uniformity of treatment, if the full set of circumstances and unique behavior of the member are taken into account. Therefore, this Chair votes against the proposal to endorse the Managing Director's letter set forth in EBS/07/16.

Mr. Saarenheimo and Mr. Bergundhaugen submitted the following statement:

We thank staff for a good and properly focused set of papers, which also makes fair account of the authorities' views. We also thank Mr. Gakunu and Mr. Mafararikwa for their useful statement. We are deeply concerned about the accelerating economic and social meltdown in Zimbabwe, and regret that the authorities have shown little interest in implementing vital measures needed to stabilize the situation. Unless the authorities immediately start assuming responsibility for the future of their country, the current dismal situation in Zimbabwe is heading for worse.

As we concur with staff's appraisal and support the proposed decisions, we would only like to emphasize a few important issues. We also urge the authorities to consent to the publication of the Article IV documents.

Article IV Consultation

The economic situation in Zimbabwe is nearing catastrophe, and staff rightly focuses on possible immediate actions which could arrest the decline. International experience from fighting very high inflation rates offers some useful, albeit rather general, insights. We note that in the past, frontloaded and broad-based reforms have been necessary to curb inflation expectations in order to restore macroeconomic stability and investor confidence.

The stabilization package sketched out by staff is appropriate from the economic viewpoint, but seems to contain actions well beyond what is currently politically feasible in Zimbabwe. In terms of practical policy, it could be considered to what extent a more limited set of reforms might help to alleviate the situation. Staff's comments would be welcome.

Given the limited scope for private or foreign short-term financing of the public deficit, a significant fiscal tightening is the centerpiece of economic stabilization. Internalization of quasi-fiscal activities (QFAs), most notably by the central bank, should be prioritized. We note that the authorities have taken welcome steps to transfer some QFAs to the government budget, and hope that the central bank will follow up on its pledge not to undertake any new QFAs. However, the lack of provisions for these activities in the already rather expansionary 2007 budget remains a concern, and demonstrates the challenge in achieving staff's recommended fiscal tightening of 10 percentage points of GDP.

Removing all fiscal entanglements of the central bank and abolishing multiple currency practices will be a prerequisite for a more credible monetary regime. The central bank should revert to focusing on its core function to stabilize prices, and we support staff's assessment that a broad monetary anchor should be implemented. While there will be significant immediate effects from allowing the currency to depreciate and unify with the parallel market, this should be pursued as a step to clarify the central bank's functions. An overhaul of the bank's legal framework, emphasizing autonomy, would also be helpful in restoring some confidence from the part of foreign investors or donors.

While restoring access to external financing represents a necessity in the medium term to facilitate growth and revitalize the private sector, it would represent an opportunity in the short term to alleviate some shortages of basic goods. In relation to this, staff envisions "some external financing from nontraditional sources." Could staff elaborate further on these sources?

Against the generally abysmal state of the economy, the banking system remains one of the few bright points, supported by a best-practice supervisory framework. As staff points out, however, the apparent profitability reflects more the hyperinflationary environment than fundamentally sound business. The current macroeconomic policies are gradually eroding the otherwise viable sector by shrinking real assets, squeezing private credit intermediation, and increasing liquidity risk. Although the sector is gradually losing its economic importance, a liquidity crisis would create serious impediments to any economic stabilization efforts and further deteriorate the living conditions for the population.

Overdue Financial Obligations and the Restoration of Voting Rights

We regret that Zimbabwe remains in continuous and increasing arrears to the PRGF-ESF Trust, and support maintaining the related sanctions. As emphasized by Mr. Gakunu and Mr. Mafararikwa, the authorities consider technical assistance as necessary to implement the reforms prescribed by staff in its stabilization package. However, given the poor record of cooperation and the limited ownership of the reform agenda by the authorities, any technical assistance would likely be ineffective. We trust that staff and management will maintain an intensive dialogue with the authorities, and will stand ready to propose restoring access to technical assistance, should the authorities' commitment to cooperate improve.

Regarding the restoration of voting and related rights, we support the proposed decision. While we strongly disapprove the misguided policies of the Zimbabwean authorities, we emphasize that the Fund must always adhere to high standards of consistency in following its policies.

Mr. Kishore and Mr. Bannerji submitted the following statement:

Staff have circulated two papers for discussion on Zimbabwe today. The first, pertains to Zimbabwe's continuing arrears to the PRGF-ESF Trust Fund. In the light of the fact that arrears have indeed increased from the time of the last review, we can endorse the proposed decision contained in page 7 of the paper.

On the second and admittedly more important issue of restoration of Zimbabwe's voting rights, we continue to subscribe to our earlier view that once a country fulfils its obligation in clearing its arrears to the General Resources Account (GRA), the causes leading to the suspension of voting rights, in the first place, have been substantially cured. While the legal view is that the Executive Board can, in its discretion, suggest additional conditions preceding readmission to Fund membership, exercising such discretion in respect of one country should be done in a manner that would not violate the Fund's fundamental principle of uniformity of treatment. We also fail to see the logic of prescribing a set of strict conditionalities for Zimbabwe with ostensible objective of avoiding a potential breach of Article VIII, Section 5, when staff have stated that they are not in a position to conclude that Zimbabwe's earlier reporting and subsequent revisions of reserves data were inaccurate for the purposes of Article VIII, Section 5.

We would reiterate that Zimbabwe's voting rights should be immediately restored. We understand that the Governor of the Central Bank of Zimbabwe has given a written undertaking to carry out a core reform program. The IMF should ask for definite timelines of these reform milestones pari passu with the restitution of voting rights.

We recognize the need for Zimbabwe to undertake a comprehensive economic reform implementation program for its own growth, development and social equity consistent with the expectations of the international community, and would therefore like the IMF to be reassured of the authorities' commitment to the suggested reform program, policy and practice measures on the line suggested by the Managing Director in his proposed letter. However, this should be expected of Zimbabwe with a view to enabling the IMF to take effective steps toward restoration of Zimbabwe's voting rights at the earliest opportunity.

Mr. Silva-Ruete and Mr. De la Barra submitted the following statement:

The recent developments in the economy of Zimbabwe are a matter of concern. The staff report underscores that Zimbabwe's economy has deteriorated significantly and the outlook is even more worrisome in light of the unsound policies that have been implemented, which could lead to greater instability and a worse scenario in the short term if not corrected. GDP growth has been negative in the last 4 years, the fiscal deficit has widened considerably and it is even greater if the quasi-fiscal activities (QFA) are combined into the fiscal budget. Staff projections show a dismal situation for fiscal deficit in the year 2007. Similarly, international reserves have diminished constantly, leading to a shortage in foreign currency, reflected on the increasing gap between the several official and market rates.

As a result of the increasing fiscal expenses the inflation rate has grown dramatically up to 1281 per cent by the end of 2006. We all know that in situations like this there is a high risk of losing control of the economy and getting into a speedy hyperinflation. Even though the financial sector has been able to maintain financial intermediation in Zimbabwe, chances are that run-offs will emerge in the short term because of the highly negative interest rates which are descending rapidly as inflation grows. Additionally, there is a high likelihood of the liquidity risk in the banking system becoming a real loss. Needless to say that banking system run-offs will worsen the foreign currency shortage.

We support the policies the staff recommends because there in not much room for alternative policies. In fact, for example, ending QFA is a must for the authorities in order to combat high inflation in the short run. We are aware of the high social costs that these policies imply, but the later they are taken, the more costly they become.

At this time, we want to strongly recommend the authorities to follow the staff's recommendations in order to effectively tackle fiscal deficit and inflation in order to avoid hurting the Zimbabwean population with food and other goods shortages, which usually arise during times of inflation. We also call for the authorities' strong commitment in policies they are going to implement.

Even though we endorse the staff's position regarding the needed policies to overcome the Zimbabwean crisis, we believe that technical assistance is necessary to help the authorities have better suited corrective actions. Usually, authorities facing high inflation in their countries do not the experience the staff has, as it has dealt many times with resolving such crises. Besides, the IMF has to show itself as a cooperative body for the countries, especially during hard times. We strongly believe that the staff's recommendation, as well as Zimbabwean authorities' goals, would be reached more rapidly if technical assistance is provided, so we think such assistance should be restored immediately for Zimbabwe.

In spite of Zimbabwe's cleared arrears to the General Resources Account, the Executive Board did not restore its voting rights, even though such a clearance was enough to do it. We do not agree with the staff's proposal on keeping the sanction against Zimbabwe. As far as we are concerned, wrong information or no information provided by any country is not grounds for voting right suspension. We also consider that the potentiality of breaching should not be taken into account to impose such a sanction.

It is necessary to recall that the IMF as a whole should keep in mind that helping countries must be also a matter of concern. Zimbabwe needs to restore good relations with the IMF, because it allows to establish grounds for negotiations with donors and other countries. Imposing one more year of sanctions could seriously harm the international reputation of Zimbabwe and worsen its crisis. Therefore, we call for an unconditional restoration of Zimbabwe's voting rights. However, we support the staff's request for accurate and timely information on international reserves in order to monitor and help Zimbabwe.

Regarding the arrears on PRGF-ESF Trust, we support the staff's proposal on this matter.

With these comments, we wish the Zimbabwean authorities every success in their endeavors.

Mr. von Stenglin and Mr. Denk submitted the following statement:

On Zimbabwe, we see ourselves confronted with two straightforward tasks and a very difficult one.

The first straightforward task begins with thanking staff for their excellent surveillance work under most difficult circumstances. In their candid and concise staff report and selected issues paper, they paint a depressingly realistic picture of Zimbabwe's economy. Zimbabwe's score regarding the Millennium Development Goals gives a first hint at the humanitarian consequences of the authorities' self-destructive economic policies. The staff report is also very clear in its advice on how Zimbabwe could escape the downward spiral of its contracting economy—and the upward-spiral of hyperinflation. The selected issues paper on high inflation episodes draws upon the wealth of the Fund's cross-country experience and is particularly insightful. We thus fully support the staff's message that Zimbabwe's economic crisis "calls for the urgent implementation of a comprehensive policy package centered on fiscal tightening and exchange regime and price liberalization."

The second straightforward task regards Zimbabwe's overdue financial obligations to the PRGF-ESF Trust. We fully support staff's recommendation to adhere to the remedial measures the Board has taken (declaration of noncooperation, suspension of technical assistance, and ineligibility for access to PRGF-ESF Trust resources). We are concerned that the payments record has deteriorated since the last review in March 2006. Despite the then-Finance Minister's announcement that PRGF-ESF Trust arrears would be fully repaid in equal quarterly payments from June 2006 through December 2009, no such payments have been received. Although it could be argued that weak economic conditions have made it increasingly difficult to fulfil financial obligations, this argument loses validity when taking into account that the crisis is entirely home made.

The difficult task concerns the decision on Zimbabwe's voting and related rights.

This Chair attaches great importance to the principle of uniformity of treatment. We thus understand the concerns other Directors have expressed in this regard. Yet in the case of Zimbabwe we face a unique situation: Zimbabwe has paid its arrears to the GRA but must be considered in potential breach of several other obligations to the Fund (specifically Article VIII, Section 2 (a), 3, and 5). It is true that other countries sometimes do not fully comply with these Articles either—without sanctions being imposed. However, the scope and depth of Zimbabwe's noncooperation clearly stands out. Moreover, it seems utterly reasonable, in our view, to demand a higher standard from a country that wants its rights to be reinstated than from those who are in good standing. It is thus up to Zimbabwe's authorities to bear the burden of proof. Finally, other countries in the past had SMP-supported policies in place that were designed to bring them into compliance with their obligations. In Zimbabwe's case, by contrast, we currently see very little to give us confidence that the authorities will adhere to the rules of the Fund in the future.

We find it therefore reasonable that the Board prudently exercises the discretionary power it is vested with (see BUFF/06/44) and requires Zimbabwe to fulfil relevant conditions before its voting rights are restored. The reporting requirement proposed by staff constitutes in our view a reasonable and necessary condition to that effect. But in the light of the gravity of Zimbabwe's noncooperation, this condition alone seems not sufficient to assure us of Zimbabwe's willingness to cooperate. We are thus of the opinion that more stringent conditions would be needed. These conditions, however, must be strictly related to obligations under the Fund's Articles of Agreement.

Looking forward, we would find it extremely difficult to support Zimbabwe's restoration of voting rights if only reserve reporting were to improve but Zimbabwe continued to be strikingly uncooperative with respect to its other obligations. Under these circumstances, a normalization of relations with the Fund would also be very hard to explain to the public at large, particularly if it were sold by the authorities as a signal of approval of their course.

We therefore do not support the proposed decision.

Mr. Sadun and Mr. Cipollone submitted the following statement:

We thank staff for the well-written report and for their much appreciated efforts to remain engaged with the authorities.

Economic and Social Development: From Bad to Worst

The deterioration of the economy has accelerated. While the official inflation indicator accelerated to over 1,000 percent, the staff believes that the real inflation rate is more than double. Economic activity has continued to shrink with severe consequences for the well-being of the population, which is falling into poverty very quickly. The high and growing fiscal deficit, fueled by the accelerated budget spending and Reserve Bank of Zimbabwe losses, is the main driving force of the hyperinflation. The primary deficit is expected to double, reaching 40 percent of GDP.

We believe that the situation might reach the point of no return if drastic measures are not adopted. The economic slump could further accelerate due to the growing financing needs and to hyperinflation stemming from the large expansion of money supply needed to finance skyrocketing fiscal deficits.

Policy Adjustment: Radical Changes are Necessary to Change the Course

Staff is proposing a stabilization plan that would help bring inflation down somewhat, to 450 percent by the end of 2007. This plan features a 10-percentage point cut of the primary deficit in order to contain it to only 15 percent. This would imply substantial cuts to the wage bill and subsidies to firms.

We appreciate to the staff's efforts in drawing this possible stabilization plan, based mainly on a sharp reduction of the primary deficit. We agree that a sharp fiscal adjustment might have expansionary effects. In this particular case, however, halving the primary deficit would still not be enough to generate any beneficial effects, if not supplemented by a rapid liberalization of prices and exchange rates.

In any case, we note that the authorities remain unconvinced about the benefits of this plan and that they are not interested in changing direction. Furthermore, even if this scenario materialized, it would only be the first step toward implementation of the unfinished structural and institutional agenda required to bring the country back on track.

PRGF Trust Fund: The Re-accumulation of Arrears to the Trust is Unacceptable

We regret that the arrears to the PRGF-ESF Trust have increased. This is in contrast with the past authorities' promises to normalize the financial relationship with the Fund, started with the full repayment of the GRA. The decision to almost discontinue repayment to the Trust is in contradiction with the authorities' claims that they want to seek a dialogue with the international community. The PRGF-ESF Trust is an important pillar of the international community's efforts to make available additional resources for its most needed members. Tangible progress to clear the outstanding PRGF-ESF arrears is an essential element in assessing the authorities' real intention to fully cooperate with the Fund and with the entire donor community. In light of this situation, we believe that the staff recommendations are fully justified and therefore we fully support the ongoing suspension of any technical assistance.

The Managing Director's letter to the Authorities: A Reasonable Solution to the Deadlock

We understand the reluctance of the Managing Director and the staff to move into uncharted territory, both from a legal perspective as well as for policy considerations. Indeed, their proposal aims to avoid a precedent that might condition in an unwanted way our future deliberations. We see merit in this approach and we consider the requirement of a one-year reporting of reserves, needed to comply with Article VIII, Section 5, as a minimum precondition to initiate the process for the restoration of Zimbabwe's voting rights. This condition is in line with the grave concerns voiced by several Directors about the sources of the country's payments for clearing its GRA arrears.

After the repeated failures of the authorities to heed our call for a radical change in the direction of their economic policies and for re-engagement with the Fund, we have some doubts about their willingness to improve their cooperation. However, we are prepared to explore this opportunity to break the current deadlock and we see in the Managing

Director's letter to the authorities a reasonable solution; therefore, we are ready to support it.

Mr. Larsen and Mr. Williams submitted the following statement:

Key Points

- We are concerned by the significant deterioration that has taken place in Zimbabwe since our last discussion. The fact that staff believe this deterioration is gaining momentum is very worrying;

- The situation faced by the ordinary citizen is very grave and the broad headlines—GDP has contracted by 30 percent since 1999, inflation is now 1600 percent and expected to rise to over 5000 percent by the end of 2007, poverty has increased substantially, hunger is widespread, and life expectancy is the lowest in the world (34 years for women and 37 years for men)—are disturbing;

- Faced by this situation, the authorities have, according to staff, "made no progress on structural reforms." We agree but cannot understand the reasons for inaction;

- We urge the authorities to put in place a sustainable and comprehensive macroeconomic program to start the long road to reversing this situation. The staff recommendations, based, as they are, on past experiences faced by other economies in a similar position, are right and sensible and should be implemented with utmost haste if the situation faced by ordinary Zimbabweans is to improve;

- We agree with management that Zimbabwe should demonstrate a one-year track record of meeting the obligations of Fund membership before having their voting rights restored and that the steps should be rooted in Article XXVI. We do not believe though that the step it proposes sufficiently addresses the scope of breaches of obligations under the Articles of Agreement. We therefore cannot support it;

- We could, however, have supported a decision which encompasses other obligations under Article VIII; and

- We support the proposed decision on the overdue financial obligations to the PRGF-ESF Trust.

We thank staff for the helpful set of papers they have provided for this meeting and Messrs. Gakunu and Mafararikwa for their statement, which sets out clearly the position of the authorities.

Zimbabwe's socioeconomic position has continued to deteriorate since our last discussion and, according to staff, the deterioration is gaining momentum. The situation faced by the ordinary citizen is very grave and the broad headlines are very stark:

- Zimbabwe has suffered the sharpest recorded contraction of any peacetime economy (real GDP has contracted by 30 percent since 1999);

- inflation is now around 1600 percent (end-January 2006)—although the staff reports suggests that staff estimate the figure to be over 2000 percent—and, in the absence of a comprehensive package of remedial measures, is projected to increase to over 5000 percent by the end of the year;

- a country that used to export food now imports it because agriculture output has dropped dramatically and there are now substantial food shortages—a direct result of chaotic land reform and inappropriate exchange rate policies, price controls, and import restrictions;

- poverty has substantially increased and social indicators have worsened—human development indicators that were once among the best in sub-Saharan Africa have deteriorated sharply—and Zimbabweans have the lowest life expectancy of any country in the world: life expectancy has now declined to well below 40 years (34 years for women and 37 years for men) from 60 years 15 years ago;

- over two-thirds of Zimbabweans are unemployed;

- the HIV/AIDS infection rate is among the highest in the world, affecting around 25 percent of the population; and

- child mortality has risen very sharply.

As the staff report notes, this deterioration has been the result of the authorities' poor economic and political management and weak governance: the effects of inappropriate macroeconomic policies—especially the continued use of quasi-fiscal activity, price controls, import restrictions—have been exacerbated by concerns over political developments, weak governance, endemic corruption, disregard for the rule of law, chaotic implementation of land reform, and the disastrous humanitarian and economic consequences of Operation Murambatsvina. This crisis has shattered investor confidence and seriously undermined the very institutions necessary to turn the situation around.

Faced with this very grave situation, we are concerned that the Zimbabwean authorities have, until very recently, decided to take little or no action. We note that the staff believe that “there has been no progress on structural reforms” (Paragraph 26 of SM/07/58) and that “the policy framework in the Monetary Policy Statement lacks credibility in the absence of decisive and upfront action to lower the fiscal deficit, including quasi-fiscal activity of the RBZ, and liberalize prices, including the exchange rate” (Paragraph 8 of SM/07/58/Supplement 2). We agree with these assessments but cannot understand the reasons why the authorities have not taken decisive action.

We also note that there has been a lack of cooperation with the Fund on the re-payment of arrears to the PRGF-ESF Trust even on the timetable the authorities committed to in our last discussion.

We support the analysis and recommendations in the Article IV report and the excellent selected issues paper. In particular, we urge the authorities to set out—and begin implementing—a sustainable and comprehensive macroeconomic program to start moving along the long road to reversing this situation and improving the terrible situation faced by ordinary Zimbabweans. The staff recommendations in paragraph 20 of SM/07/58 based, as they are, on past experiences faced by other economies in a similar position, are right and sensible and should be implemented with utmost haste.

We note from the 2006 Article IV report and its supplement that the authorities agree in very broad terms with the recommendations put forward by staff but do not believe they have the support at the “highest political level.” That said, there are places where the staff report is not definitive and we would be grateful if staff could confirm that:

- no new quasi-fiscal activity (QFA) has been entered into by the Reserve Bank, its entities, and other state institutions;

- all QFA has been—and, as new QFA is due, will continue to be—transferred to the budget in a timely and transparent fashion and that adequate provision has been made in the budget to meet the cost;

- the authorities intend to ease exchange-rate restrictions and abolish their very significant package of multiple currency practices (MCPs);

- the National Incomes and Pricing Commission will move to free prices;

- hard budget constraints will be placed on all state entities (including parastatals and the entities owned by the Reserve Bank).

We welcome the discussion on Zimbabwe's voting and other related rights. Like management we believe that it is important that the Board sets out very clearly to the authorities what steps it believes are necessary for the restoration of voting and other related rights. We agree that the steps should be rooted in Article XXVI, that is to address breaches of members' obligations under the Articles of Agreement. In our view, these conditions should also be limited to those areas where breach has been the most flagrant and consistent over time.

We note that a fundamental building block of the management proposal is to ensure that Zimbabwe should demonstrate a track record of one year of meeting the steps set out by the Board in order to ensure that there is compliance with the obligations of Fund membership before having their voting rights restored. We think that is right and strongly support it.

We agree with management that the authorities have breached the obligations under Article VIII, Section 5—the reporting of international reserves. However, in our view, to limit the step for the restoration of voting and other related rights to this one area is insufficient and is not commensurate to the breach of other important obligations for Fund membership. We cannot therefore support this being the sole step for restoration of voting rights and would like to be recorded as opposing management's proposal.

As noted by the very helpful Informational Annex to the 2006 Article IV report (SM/07/58/Supplement 1), Zimbabwe has consistently breached the obligations under Article VIII, Sections 2(a) and 3 of the Fund's Articles of Agreement. What is more, the staff analysis suggests that the authorities' current actions are increasing noncompliance with this obligation at the very time when they are seeking restoration of the full rights of Fund membership. In our view, any decision to restore voting and other related rights to Zimbabwe should therefore only be taken after the authorities have demonstrated compliance with this obligation in a sustainable manner and a period of one year.

Consistent with this line of reasoning, and in an attempt to secure as big a consensus in the Board behind the steps necessary to restore Zimbabwe's voting and other related rights as possible, we would like to have had these two steps taken together.

An approach along these lines could have secured our strong support and would have been consistent with the authorities' own commitments, as set out in their November 2006 budget statement and their recent Monetary Policy Statement, and with their stated intentions as communicated to Fund staff (as set out in the 2006 Article IV staff report (SM/07/58) and the recent supplement to it (SM/07/58/Supplement 2) which records these commitments in a letter to Fund Management). Such an approach would have required the authorities to:

i. 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;[1]

ii. demonstrate progress toward complying, on a sustainable basis, with obligations under Article VIII, Sections 2(a) and 3. In this regard, the authorities will be required, for one year, to eliminate the multiple currency practices subject to the Fund's jurisdiction, and to not intensify existing, or impose new, exchange restrictions on the making of payments and transfers for current international transactions.

In assessing whether the above conditions have been met in a manner which is sustainable and consistent with securing macroeconomic stability, the Board should recommend that staff take account of progress on implementing key supporting macroeconomic polices during the one year track record (as outlined in paragraph 20 of the 2006 Article IV staff report (SM/07/58)), especially:

- halting all new quasi-fiscal activity carried out by the Reserve Bank of Zimbabwe, its entities and other state institutions;

- transferring all existing (and committed) quasi-fiscal activity to the government budget in a transparent and timely manner;

- imposing a hard budget constraint on public enterprises;

- substantially tightening fiscal policy;

- establishing a strong nominal anchor; and

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[1] This is identical to management's own proposal

- using the National Incomes and Pricing Commission to free prices.

We believe that this approach would have been consistent with objective of ensuring that restoration of voting and other related rights takes places only when the authorities have met their obligations under the Articles of Agreement.

Finally, we support the proposed decision on the overdue financial obligations to the PRGF-ESF Trust (EBS/07/15).

Mr. He and Mr. Zhong submitted the following statement:

Having experienced real GDP contraction and high inflation since 1999 due to policy shortcomings, international isolation, and other constraints, the Zimbabwean economy is at a critical juncture. It is vital that the authorities implement a comprehensive package of reforms promptly in line with staff's recommendations and the reform initiatives outlined in Dr. Gono's letter under a "social contract" to stabilize the economy is an encouraging step forward. Moreover, the elimination of staple food subsidies—on maze and wheat—in the last two weeks and the liberalization of remittance inflows partly confirm the authorities' commitment to serious reform. We believe that such commitment and reform should be encouraged by the Fund and—given the authorities' poor policies over the last few years—that it lend its support with technical assistance.

Like Ms. Phang and Mr. Win and other Directors, we believe that Zimbabwe's voting rights in the Fund should be restored immediately and unconditionally and that its ineligibility to use the Fund's general resources be terminated, as the basis for the suspension of voting rights, i.e. its arrears to the GRA, were eliminated a year ago. The prolonged suspension of voting rights without solid basis could damage the Fund's image as an institution for international financial cooperation and prevent Zimbabwe from obtaining more needed international support for a comprehensive reform program to stabilize its economy.

It is regrettable that progress in resolving Zimbabwe's arrears to the PRGF-ESF Trust has been much slower than the authorities previously indicated. However, since the satisfactory solution of this problem largely depends on rejuvenating the economy—thereby generating adequate repayment capacity—we believe the continued suspension of technical assistance will delay the solution and should be lifted.

Messrs. Guarnieri, Guzmán, and Guerra submitted the following statement:

With regard to the lifting of the suspension of voting and related rights, we believe that the only consideration should be that a member has remedied the breach of obligations that provided the basis for the procedure of compulsory withdrawal of Article XXVI.

The Board's discretionary powers on the timing of the lifting of the suspension of voting rights are limited because any decision on these matters has to be related to the original Decision that initiated the procedure. We do not interpret that rules K-4 and K-7 allow us to indefinitely maintain the agreed sanction for a behavior that has ceased. Furthermore, the exercise of such ample powers by the Board requires a restrictive approach that needs to be consistent with general legal principles, in particular, the predictability in the application of the rules and the uniformity of treatment. Zimbabwe has no outstanding obligations to the GRA so the original basis for the suspension of voting and related rights no longer exists. We concur with the statement by Mr. Mozhin and Mr. Tolstikov, and we continue to support, as we did before, the unconditional restoration of Zimbabwe's voting rights.

We do not find a basis for the proposed conditionality on the reporting of international reserves. In particular, the report on the subject states that 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. If a case of breach of obligations under the Articles, on this matter or on any other, has to be made, it should be considered in a separate process and decision, and supported by a clear assessment on the case by staff.

We are deeply concerned with the situation in Zimbabwe. We urge the authorities to express their strong commitment to the implementation of a structural package of economic reforms to limit the already great damage to the economy. We strongly support the economic measures proposed by the staff under the Article IV consultation. We commend staff for developing such a comprehensive policy package. The authorities of Zimbabwe should immediately implement such policy package centered on fiscal tightening, exchange rate regime and price liberalization.

Finally, given that Zimbabwe has not covered its financial obligations to the PRGF-ESF Trust, we support the proposed decision on this matter.

Mr. Duquesne submitted the following statement:

At the outset, we would like to thank staff for their comprehensive report on the country's situation, despite limited access to data, as well as for the selected issues paper and report on Overdue Financial Obligations to the PRGF-ESF Trust. We would also like to thank Mr. Gakunu and Mr. Mafararikwa for their statement.

First, on the Article IV consultation, we fully share staff's concerns on the gravity of the macroeconomic situation of Zimbabwe, which cannot be explained by sanctions. As described in the staff report, Zimbabwe's economic and social conditions have been spiraling downward, mainly as the result of inappropriate macroeconomic policies and weak governance with severe consequences in terms of poverty and social unrest. The economic decline has even accelerated over the last few months, with inflation skyrocketing. The weakening of property rights and governance has further undermined the private sector environment, and there are serious risks of food shortages. We are very concerned by this situation.

We strongly urge the authorities to implement measures outlined by staff in order to restore stability and growth. The authorities still need to urgently implement a comprehensive program of stabilization to bring macroeconomic stability back on track with a credible fiscal adjustment and sound monetary policy—going beyond curtailing the quasi-fiscal activity of the central bank. They also need to implement fundamental structural reforms in order to regain confidence in the economy. They should as well make strides, particularly in the areas of rule of law, fight against corruption, enforcement of property rights, and public transparency.

Turning now to arrears to the Fund, we are highly disappointed to note that arrears to the PRGF-ESF Trust Fund have worsened markedly since the previous review. We regret that the assurances given by the authorities to take prompt action at the occasion of the last Board meeting were not fulfilled. We therefore strongly urge the authorities to honor their repayment program to resolve the remaining overdue financial obligations. Consequently, we support the proposed decision to maintain the remedial measures adopted by the Board to address Zimbabwe's PRGF-ESF Trust arrears.

As for the staff's proposal on Zimbabwe's voting and related rights, we recall that, at the Executive Board meeting on March 8, 2006, we were in favor of restoring the country's voting rights and its eligibility for the Fund's general resources as a consequence of Zimbabwe's clearance of its arrears to the General Resources Account (GRA). At that time, we stressed the need for this discussion to be based on sound legal arguments; accordingly we were ready to support staff's and management's proposal at that time.

Staff's new proposal is based on conditioning the lifting of sanctions against Zimbabwe on a one-year track record of accurately reporting its international reserves, verified by the external audit. We take note of the staff assessment in paragraph 6 of EBS/07/16 that this solution is: (i) consistent with the rules governing voting rights; (ii) consistent with the principles of uniformity of treatment. Moreover, according to staff it avoids creating a precedent for more onerous conditions that the Fund might be unwilling to apply in future cases.

Against such a background, we are ready to support staff's proposal.

To conclude, we stress once again the real sense of urgency for the authorities to implement a comprehensive policy package, in close cooperation with the Fund.

Mr. Rutayisire submitted the following statement:

We thank Mr. Gakunu and Mr. Mafararikwa for their informative statement and staff for a useful set of papers on Zimbabwe. As staff acknowledges (in EBS/06/25):

- Zimbabwe has cleared in full its arrears to the General Resources Account on February 15, 2006;

- Zimbabwe no longer has any outstanding obligations to the GRA that could result in GRA arrears reemerging; and

- Zimbabwe is no longer in breach of those financial obligations that gave rise to the decision to suspend its voting rights.

This is also emphasized by Mr. Gakunu and Mr. Mafararikwa in their statement as well as Ms. Phang and Mr. Win, Mr. Mirakhor and many other Directors in their statements. As demonstrated in the staff report, the authorities have cooperated with the Fund on issues regarding the reporting of reserves. The letter sent by the Governor of the Reserve Bank of Zimbabwe also indicates how much the authorities have cooperated by taking seriously the recommendations made by staff during their last visit to Harare. We note that the authorities have begun implementation of these recommendations albeit there is still a long way to go in this direction.

In this light, we support the immediate and unconditional restoration of Zimbabwe’s voting and related rights and the termination of Zimbabwe’s ineligibility to use the Fund’s general resources. Sanctions imposed on a member should be lifted once the breach of obligations that led to the sanctions is remedied and they should not be maintained on the basis of potential breach of obligations. Further delays in this matter run the risk of undermining the credibility of this multilateral institution.

As regards the general obligations of Zimbabwe under the Article IV, which is a separate matter from the issue of voting rights, we encourage the authorities to take necessary actions to pursue macroeconomic stabilization and restore conditions conducive to the resumption of economic growth. We support the reform package proposed by staff and we are reassured that the comprehensive package of reforms identified by the authorities with a view to deregulating and stabilizing the Zimbabwean economy are consistent with staff advice. As highlighted by Mr. Gakunu and Mr. Mafararikwa in their statement, the authorities’ reform package includes, in line with the recommendations made by staff, the transfer of quasi-fiscal activities to the budget, tight fiscal policy, price deregulation, imposition of hard budget constraints on public enterprises, establishment of a strong monetary anchor, and liberalization of trade and the exchange system. We urge the authorities to promptly implement these measures.

On the reporting of international reserves, we welcome the fact that the authorities have promptly moved to apply the new Fund template to the reporting of reserves starting from October 2006 as outlined by Mr. Gakunu and Mr. Mafararikwa. The authorities should be encouraged to pursue this direction. We note the authorities’ determination to continue reserve reporting and agree with them that such reporting should not be part of sanctions or conditionality.

We support the authorities’ call for the Board to lift the ban on technical assistance so as to help the authorities implement their comprehensive set of reforms. We also see the need for the Fund to remain constructively engaged in Zimbabwe.

Mr. Shaalan and Ms. Choueiri submitted the following statement:

We thank staff for a set of comprehensive reports, and Mr. Gakunu and Mr. Mafararikwa for their helpful statement. We are also grateful for staff and management for their continued efforts to normalize Zimbabwe’s relations with the Fund.

Restoration of Voting and Related Rights

On the occasion of the March 2006 Board discussion, following Zimbabwe’s full settlement of its overdue financial obligations to the General Resources Account (GRA), we supported an immediate lifting of the suspension of the country’s voting rights. Our decision was based on the fact that: (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, and (ii) Zimbabwe no longer had any outstanding obligations to the GRA that could result in GRA arrears reemerging. We remain of the view that Zimbabwe’s voting and related rights should be immediately restored. As indicated by Mr. Mozhin and Mr. Tolstikov, and by Mr. Alazzaz, failure to do last year has not been in the interest of either Zimbabwe or the Fund.

Staff Report for the 2006 Article IV Consultation

As noted in the staff report, Zimbabwe’s economic and social conditions continued to deteriorate severely over the past year, with a marked reduction in output and spiraling inflation. Therefore, curtailing this deterioration effectively requires timely adoption and implementation of a comprehensive package of macroeconomic and structural policies, along the lines suggested by staff. Like Mr. Mirakhor, we view political commitment and domestic consensus as essential ingredients for the implementation of the adjustment and reform program.

Overdue Financial Obligations to the PRGF-ESF Trust

The deterioration in Zimbabwe’s cooperation with the Fund since the last review, including payments of arrears to the PRGF-ESF Trust, is unfortunate. We therefore encourage the Zimbabwean authorities to maintain their efforts to resolve the remaining overdue financial obligations to the PRGF-ESF Trust, and agree to consider further these overdue financial obligations in six months.

We would, however, favor the resumption of technical assistance, which may prove helpful in supporting Zimbabwe’s stabilization and structural reforms efforts, thus potentially contributing to the general welfare of the population.

The Acting Chair (Mr. Kato) noted that a revised version of the staff's report on the restoration of voting and related rights had been distributed to Directors, and asked the Acting Secretary to explain the revision.

The Acting Secretary (Mr. Esdar) remarked that the signature marking ("/s/") preceding the name of the Managing Director at the bottom of page 6 had been removed to clarify that the draft letter had not yet been signed. No substantive revisions had been made to the report itself.

The Acting Chair (Mr. Kato) reminded the Board that it had an obligation to come to an agreement on the further actions that would constitute a basis for restoring Zimbabwe's voting and related rights. Work had been ongoing for nearly a year in an effort to find a way forward and it was incumbent on all to find common ground. Management's proposal attempted to bridge the differences of views that were expressed at the last meeting on Zimbabwe. He appealed to Directors to reassess the options at hand in order to close the matter.

Extending his earlier remarks, Mr. Gakunu made the following statement:

> Mr. Chairman, I distributed my preliminary statement, but I need to clarify two key issues, particularly in view of the Supplement 2 issued by staff yesterday.
>
> First, Board members are fully aware that we have been grappling with Zimbabwe's inaction on the policy front, in the face of unprecedented socio-economic deterioration. Nations make mistakes, but in one way or another, they get to realize their mistakes and correct them, either on their own accord or with assistance from the international community.
>
> Zimbabwe has made mistakes on the economic front, and I want to confirm that the country has realized its mistakes and is ready to correct them. I went to Zimbabwe in November of last year, and I want to thank management and the Board for their understanding on this point. I met the President, the Minister of Finance, and the Governor of the central bank and advised them that it was in their best interest to cooperate with the Fund and to adopt orthodox economic policies, including the cessation of quasi-fiscal activities and transferring them to the budget, the removal of price distortions, liberalization the foreign exchange system and the discontinuation of multiple currency practices, the reining-in of government expenditure and the tightening of monetary policy to reduce inflation. Already, in his budget speech late last year, the Minister of Finance indicated that quasi-fiscal activities at the Reserve Bank of Zimbabwe were to be transferred to the

budget. This was an indication that the authorities were willing to turn the corner for the better.

The Social Contract that has just been launched by the authorities represents a sea change in their thinking. I would say that it is a significant ideological change for the ruling party and perhaps the President himself. Compared to what has been happening in Zimbabwe in the past few years, bringing all quasi-fiscal activities under the budget, the removal of subsidies on maize and wheat, which are staple foods, and similar actions to be approved by cabinet next week on a range of other items, including fuel, electricity, and water, represent a significant departure. The decision to allow recipients of remittances to convert forex at a rate convenient to them should be viewed with caution, but it is the beginning, in my view, of an effort by the authorities to legalize the parallel market, and therefore progress toward unifying the exchange rates.

The key change is that the President and the ruling party are fully behind this new direction of policies. There is an internal realization that they need to change for their own sake and sequencing the measures at a pace that they can internally manage. So I would urge this Board, the staff, and management not to discard these new developments as trivial. I understand the pessimism, but I believe that we must encourage the Zimbabwean authorities to persevere in this new direction and not try to institute measures now because we think that the authorities will not endure with the reforms.

My second observation relates to the Restoration of Zimbabwe’s voting rights. The Zimbabwean authorities mobilized resources to clear GRA arrears at a time when foreign exchange was very scarce in Zimbabwe. They did so because they valued being a full member of this institution. The moment issues were raised about the source of these Funds and the Board started setting additional conditions for restoration of voting rights, the authorities, rightly or wrongly, interpreted this to mean that political considerations were at play in the decisions of the Board. This had devastating effects on reform-minded Zimbabweans and tended to bolster the view of those that argued that the Fund could not act fairly and in an evenhanded manner. Let me admit that this has not augured well for the credibility of this institution and I am happy to note that this view is shared by many in this Board. I appeal to the Board to overcome these perceptions and look at its decisions in an equitable and evenhanded manner. There are other fora more appropriately suited to handle political issues.

I thank you, Mr. Chairman.

Mr. Shaalan called on the Board to seek a compromise solution.

Mr. Saarenheimo made the following statement:

As we state in our preliminary statement, this constituency supports management in all its proposals for today's meeting. Last March, this constituency supported unconditional restoration of Zimbabwe's rights. As a way out of the current impasse, we are now ready to support the decision endorsing the Managing Director's letter, which lays out limited conditions for the restoration.

This position reflects the majority view of a split constituency. One of my countries, namely Denmark, would have preferred not to support the proposed decision. In the opinion of Denmark, Zimbabwe's violations of the Fund's Articles warrant stronger conditions, for instance in relation to eliminating multiple currency practices and exchange restrictions. Denmark considers that such conditions would be viable under the Fund's policies and rules.

Clearly, the Zimbabwean authorities have put themselves in a starkly adversarial relationship with many Fund member governments. I want to assure you that there is little sympathy towards the behavior or policies of the Zimbabwean authorities in any of our constituency capitals either.

That said, precisely because the relations with this country are so tense, this is a situation where we all need to take a step back and ask ourselves, are we taking our position for the right reasons? Would we take the same position if we were dealing with a country with less troubled foreign policy relations?

This is what my authorities have tried to do. With the exception of Denmark, they have come to support management's proposal because, regardless of their total disagreement with the policies of the Zimbabwean government, they consider that consistent application of the Fund's policies does not leave us other alternatives.

If we want to revise or reinterpret our policies, we should do so as a general policy matter. Zimbabwe would be a particularly unfortunate choice for this Board to create case law, precisely because its difficult relations with many member countries would always cast a shadow of doubt on the motives of the decision.

> Several Chairs have chosen to oppose the proposed decision, instead stating their support for immediate and unconditional restoration of Zimbabwe's voting rights. I understand this position very well—indeed, it was our position last March. However, we tried it once and it got us nowhere. The question is, how would sticking to that position help to resolve the issue? If we now follow the Managing Director's proposal, there is at least some hope that in 12 months' time, Zimbabwe will have its rights restored. If the proposal falls, how then will we get out of this impasse? In all likelihood, we would in 12 months' time be exactly where we are now, with no roadmap, and no progress in Zimbabwe's relations with the Fund.
>
> All in all, we support the roadmap as set out by management. At the same time, the Fund can and should send a clear signal that Zimbabwe's economic policies are unacceptable, and that a full normalization of relations with the Fund and the donor community will require a clear change in those policies. But there are other ways to send that signal.

Mr. Duquesne fully supported the comments by Messrs. Shaalan and Saarenheimo. He felt that the appropriate forum to comment on Zimbabwe's unacceptable economic policies was the Article IV consultation, but it was inappropriate to link developments on inflation, the current account, or economic growth to the restoration of voting rights. Moreover, the Directors opposing management's proposal needed to take into account the affect their actions would have for the Fund's image in Africa.

Mr. Prader made the following statement:

> Our Chair agrees with the staff's candid assessment of Zimbabwe's economic policy. As a result of catastrophic economic policies, the economy is in a terrible state. The authorities seem to be virtually waging an economic war against large parts of their own population. The situation could not be any worse, the speed of decline is even increasing. I have one specific comment on the staff's recommendation in the context of the forecast that inflation could accelerate to some 5,200 percent by the end of the year. I wonder if under the current circumstances it is sensible or even realistic to propose a stabilization package that would bring down inflation to about 450 percent by year-end. I think for the Fund to be associated with such a minimal inflation target is strange.
>
> On the subject of restoring voting and related rights, we would like to express our regret that the March 2006 meeting did not conclude with the adoption of the staff's proposal to restore the voting rights after the authorities had settled the arrears to the General Resources Account. We therefore

understand the position of a number of Chairs who ask for immediate restoration of voting rights. At the same time, I think we should all take up Mr. Shaalan's call for a compromise. For the sake of consensus and a constructive outcome of today's meeting, it would be best if these Chairs, and also others who oppose, reconsider and support the staff's new proposal. The new proposal should address the concerns of those who did not support the staff proposal last time on the grounds that the source of the foreign exchange used for repaying the Fund could not be clarified. The staff's proposal now allows for resolution of the issue of reserve reporting. One question in this context is whether the authorities are able and willing to meet this specific condition with the help of the Fund's technical assistance. Maybe staff can answer this question regarding the country's technical capacity.

We support the staff's and management's underlying idea behind today's proposal; namely, to preserve the credibility and integrity of our policy on overdue obligations and to prevent Zimbabwe from becoming a bad precedent for other cases. This is why we are interested in, and supportive of, a nonpolitical, technical approach. We are therefore disappointed that a number of Chairs, according to the preliminary statements, are unable to support the proposed decisions, but I still hope they will reconsider. In view of this attitude of some Chairs, it might be advisable to make it clear in the Managing Director's letter to the authorities that a simple majority of the Board for the staff's proposal today does not guarantee that after the achievement of the one-year track record there would be a lifting of the sanctions. The letter should not again leave room for unnecessary disappointments on the part of the authorities, and it is clear that I fully share Mr. Kremers' observations on this issue.

Mr. Kashiwagi made the following statement:

First, on the Article IV consultation, we are deeply concerned about the aggravation of Zimbabwe's economic conditions due to the authorities' mismanagement of economic policies. Despite various policy recommendations repeatedly expressed by the Fund, the authorities have recklessly maintained unsustainable fiscal and monetary policies without showing any sign of correcting their policy direction. Consequently, inflation has accelerated from three digits to four; the economic contraction has continued; and international confidence has suffered further erosion. Such a severe economic environment has led to a deterioration in social indicators and widespread poverty. Against this background, it is imminent that the country ensure macroeconomic stability. The authorities need to not only make a strong commitment toward stabilization, but also expeditiously implement necessary remedial measures. We believe that showing such an attitude would be critical to the recovery of international confidence in this country.

Furthermore, as constraining inflation is a key to macroeconomic stability, we urge the authorities to implement without delay the comprehensive policy package recommended by the staff. In particular, we note the accumulation of Reserve Bank of Zimbabwe's (RBZ) losses owing to the escalation of its quasi-fiscal activities led to excessive money creation and the deterioration of the central bank's credibility. In this regard, we urge the authorities recognize the adverse effects that the quasi-fiscal activities entail and to immediately eliminate them.

With regard to other measures included in the comprehensive policy package, it is critical that the authorities initiate such measures simultaneously and in an upfront manner. In this context, while the authorities emphasize the need for external support, we believe that the lack of external support cannot be used as an excuse to justify a delay in the initiation of reforms. Rather, the authorities should consider that their serious efforts to implement the comprehensive reform package are a prerequisite to achieving external support.

On Zimbabwe's overdue financial obligations to the PRGF-ESF Trust, we note that Zimbabwe's payment record to the trust account has worsened significantly since the previous review, resulting in an increase of overdue financial obligations. We also note the country's still weak governance structure and the authorities' lack of will to implement policies conducive to reaching a resolution on arrears. Against this background, we support the staff's proposal that both the declaration of noncooperation and the removal from the list of PRGF-ESF eligible countries should remain in place as remedial measures. In addition, with regard to suspension of technical assistance, while recognizing that this issue could be considered independently from the resolution of arrears, we support the staff's proposal. Given that the root cause of delayed reform in Zimbabwe is not the authorities' inadequate capacity but, rather, their lack of commitment, we are of the view that lifting the sanction on the suspension of technical assistance would be premature.

Finally, on the more difficult question on Zimbabwe's voting and related rights, as you noted, Mr. Chairman, almost 12 months have passed since the Board discussion last March without any progress. In this sense, presenting the conditions required to restore Zimbabwe's voting rights is a step in the right direction. This Chair is of the view that voting and related rights could be restored after the clearance of the arrears and that macroeconomic policies should not be conditions for restoration. Nevertheless, we abstained from the decision last March because doubts remained regarding the sources of the finances used to clear the arrears to the General Resources Account. In this respect, as Mr. Prader just noted, because management’s proposal addresses this issue by asking for continuous and transparent reporting of international reserve data, we believe the proposal is appropriate and would like to support it.

Having said that, Mr. Chairman, we have grave concerns that even if we agree to send the letter to the authorities today, as proposed, and even if the authorities have complied with the conditions at some future date, we may not be in a position to restore Zimbabwe’s voting rights. With this in mind, we would have appreciated if your proposal was supported by 70 percent majority. Unfortunately, from the statements that have been made by my colleagues so far, it seems that your proposal has been rejected by two groups of Executive Directors for completely different reasons. It seems that the Board is in a position to decide on nothing today. This is very unfortunate and regrettable. Thus, I agree with the previous speakers who have called for a compromise. I would also urge my colleagues to be cooperative, creative, and in your words, Mr. Chairman, to find a common ground to converge to a proposal that can be supported by the required majority in order to save this institution from becoming incapable of making decisions. The Fund’s credibility and image is at risk.

Mr. Loyo made the following statement:

Mr. Chairman, as you recall, the last time we discussed this issue this Chair supported the immediate and unconditional restoration of voting and related rights to Zimbabwe once the arrears to the General Resources Account had been cleared. We also stated at that time that we did not see such a restoration as any condoning by this Board of the policies implemented in Zimbabwe. We were very clear that we considered those policies to be extremely inadequate and requiring immediate change. Representatives from Zimbabwe spoke to the Board at the beginning of that meeting, and I recall that I said that I was discouraged by what I heard from them.

What has changed since then in our position? I would say nothing. The position we had then is the position that we continue to have now. I have not issued a statement, but I can tell you, Mr. Chairman, that I would subscribe to every word of the statements by Messrs. Mirakhor, Mozhin, and Guarnieri.

These three statements describe very faithfully a position that is identical to this Chair's. It is on a matter of principle that this Chair takes this position, as we had already stated last time. I also said last time that it would be important to set a road map that could lead to the restoration of Zimbabwe's voting rights, because, while we take a principled view of the matter, we also want to see the country's voting rights restored. I did not know what kind of a road map could be produced in order to put this Board in a position to indicate to Zimbabwe that it would, if not immediately, soon restore its voting rights.

Here, Mr. Chairman, I have to say that I very much appreciate the effort made by management and staff to produce such a road map, but let me just say also a few words as to why I think that the proposed road map is in several dimensions unsatisfactory. I understand that it is unsatisfactory to those who would like to have a more stringent set of conditions, but it is also unsatisfactory to those of us in the Board who worry about the precedent-setting properties of the proposed decision. In this regard, Mr. Saarenheimo made an important remark when he noted that Zimbabwe would be a particularly unfortunate choice to start producing case law, as it would be a tainted precedent-setting case.

Mr. Chairman, there are three reasons why I find the supposedly middle ground proposal of staff unsatisfactory. First, I understand that staff tried to circumscribe the conditions that would be imposed on Zimbabwe for the restoration of voting rights to a very narrow area, and did so in the hopes of producing something that would carry the least danger of setting an undue precedent. For that reason, staff focused on a very specific issue, which concerns compliance on statistical reporting. I understand staff's good faith effort in trying to get to what may look like the closest thing to an unconditional restoration of Zimbabwe's voting rights. However, to my eyes, this closeness is not assessed on an appropriate metric. It looks similar to unconditional restoration because it is a simple, narrow set of conditions. But it has a very unfortunate characteristic, namely focusing on an issue where I do not think there is a strong case that Zimbabwe has egregiously departed from the Fund's recommendations. We all are very unsatisfied with the overall macroeconomic policies in Zimbabwe, and we may all be very unsatisfied with many other dimensions of policies in Zimbabwe as they relate to obligations under the Articles of Agreement, but Zimbabwe's noncompliance with statistical reporting requirements is not very different from that observed in many other cases. There has not even been a determination that there has indeed been a breach of reporting obligations. We are just talking about a possible breach that we have not even identified. Hence, as I said, Zimbabwe does not stand out from many other cases in the membership, and this makes me even more wary about the slippery slope that many of us have in mind. To build on this metaphor, Mr. Chairman, it is as if staff had tried to make the slippery slope less slippery by trying to circumscribe conditions to a narrow area, and it may have managed to make it less slippery. The problem is that it puts us in a position in which we do not have to slip much before we hit a number of other passersby that are in circumstances very similar to Zimbabwe's in terms of statistical reporting.

Second, I think that conditioning restoration on a legal technicality will give to the world the appearance that the Fund is focusing on a side issue that is not particularly relevant issue for Zimbabwe, thus prolonging uncertainty as to how the matter will be resolved. I very much respect Mr. Duquesne's eagerness to make sure that the image of the Fund is not damaged in the outside world. But I do not think that the proposed solution will do a lot of good to the image of the Fund because, as I said, it will look as if we are just trying to procrastinate on this decision.

Third, the middle ground has a defect in that it does not embody a list of firm and sufficient conditions that Zimbabwe would need to fulfill to be sure to have its voting rights restored. At best, in view of the positions taken by a number of Chairs, it is highly uncertain whether fulfilling the proposed conditions would lead to the eventual restoration of voting rights. I would even say that there are grounds to presume that voting rights will not be restored even if these conditions are fulfilled.

Mr. Chairman, for these three reasons, I am of the view that we unfortunately do not have a real middle ground option that someone with my concerns would be willing to support at this stage. For sure, I find this regrettable. I have been among those who have called for a road map on the way forward, so I am anxious to see one materialize. I would be willing to consider a road map even though I believe that the restoration of voting rights should be immediate and unconditional. I would be willing to go along with a road map if, indeed, it did not have the problems that I mentioned, and would do so for the sake of Zimbabwe's own interests. However, I do not find the package that we have satisfactory. This is unfortunate. I agree with all the others who are frustrated by not having one, but it is the reality.

Mr. Kishore made the following statement:

I am taking heart in Mr. Shaalan's call to make a concerted and cooperative effort this morning to reach an agreed decision. It is important that we do so not only because we should not appear to be indecisive, but also because the issue before us is not just a bilateral issue; it has deep and wide ramifications of a multilateral nature.

One year ago, Zimbabwe fulfilled its requirement to clear all its arrears to the General Resources Account (GRA). It is our firm belief that it is both legal and equitable for the Board to decide that Zimbabwe's voting rights should be restored. I will not go into the legality of the situation, which is not in doubt. Strictly speaking, the arrears to the PRGF-ESF Trust and those to the GRA have to be considered separately. While this Chair fully supports the proposed action with respect to the PRGF-ESF Trust, because it is a separate legal entity and requires a separate set of actions, we have an equally strong and clear view on the question of the restoration of voting rights. I call upon my colleagues here to very dispassionately and seriously consider the following.

First, legally speaking, all of the circumstances that led to Zimbabwe's suspension have been remedied. We have gone through the motions as stipulated in the Articles and Bylaws, Rules, and Regulations, and while admittedly there is an element of discretion with the Board, this discretion is to be applied not in an arbitrary fashion, but rather discreetly. One must dispassionately examine the issues that might justify continuation of the suspension. It is my belief that legally speaking the situation has been remedied and therefore we should restore voting rights forthwith.

Second, this Chair is not in a position to endorse all the economic and financial policies that are being followed in Zimbabwe. In fact, on the contrary, there is a belief and a sound conviction, taking into account the evidence and the admission by Mr. Gakunu, that there is a lot found wanting in those policies. There is an urgent need to exhort, persuade, and convince the authorities that a comprehensive policy package should be immediately implemented and measures undertaken to arrest the deterioration of the crisis. This will also be necessary to restore international confidence in Zimbabwe.

Third, though no time limit is prescribed, it is mandatory upon the Board to agree on and present a written report to the authorities. We have taken one year and one week and we have been unable to agree on what further actions are needed. I have no desire to get into a semantic discussion on what is implied by 'further actions.' The veterans around the table and the senior staff would recall that the word 'conditionality' has carried for decades carried a pejorative connotation in relation to the IMF. I believe the Board should specify very clearly to the authorities what further actions are expected.

By prolonging this suspension and leaving the entire matter hanging in the fire, what are we doing? A simplistic response would be ‘why does it really matter?’ Even if we immediately restored the country’s voting rights, is there a credible expectation that the situation will improve? Certainly, by not restoring voting rights we would be prolonging Zimbabwe’s isolation. The IMF’s mandate and indeed expediency calls upon all of us to convey the sense that we are not contracting the universal umbrella. We must appear inclusive, rather than selective or exclusive. I am not asking for a vote or a decision today, but if we reach a robust understanding based on a dispassionate analysis that voting rights must be restored, then perhaps calling upon the authorities to discharge a certain set of expected actions would be more credible and there might be a chance that we could see a turnaround on the part of Zimbabwe. Having said that, we are seeking firm political commitments on the part of Zimbabwean authorities. Permit me to say, Mr. Chairman, the commitments which last and generate results have to be mutual in nature. Let us, as an international community, present our commitment to hold the hands of Zimbabwe and then expect an action from a member country.

I conclude by making one simple observation; in view of the fact that immediate and comprehensive policy actions are required from the Zimbabwean authorities, I am comforted by Mr. Gakunu’s statements that the authorities are prepared to take such actions, as also indicated in the letter on record from the Governor of the Reserve Bank. In that light, I suggest we might consider the following: that we reach a clear understanding that in a stipulated timeframe voting rights shall be restored and that such-and-such actions are expected by the IMF. With regard to the PRGF, the staff has done an excellent job in identifying which are the vulnerable areas and where policy action is required. As far as the question on voting rights is concerned, without using the word ‘conditionality,’ we may specify what further action is required and the Zimbabwean authorities should be prepared in a bona fide fashion to undertake those commitments. The action could be reserve reporting, as is stipulated in the proposal, with a minor amendment that instead of requiring monthly reviews for 12 months, we could consider bimonthly reports with a final review in 6 months, whereupon the Board might render a decision. I am of the very clear view that without any other extraneous considerations, this body should take a consensual view and hold the hands of a defaulting country. There is a hope that perhaps we may be able to help it recover from the default and be a fruitful, cooperative, and positive member of the committee of nations here around this table. I rest my submission here, Mr. Chairman. Thank you very much for the indulgence.

Mr. Mozhin said he agreed with many of the points made by Messrs. Loyo and Kishore, but stressed that the discussion at hand was not entirely about Zimbabwe—it was also about the Fund. If a group of members was willing to use the Fund as an instrument of political pressure against Zimbabwe, then the same could happen to any country. As a result, the Fund would no longer be seen as a friendly, cooperative, and rules-based institution, marking a sea change in attitudes toward the Fund, with important implications for members' positions on other Board discussions, e.g., the 1977 surveillance decision or the medium-term strategy. It might become necessary for members to reconsider their positions given the need to protect themselves from potential hostility from the Fund. Thus, the loser of the discussion was not necessarily Zimbabwe, but rather the Fund.

The staff representative from the African Department (Ms. Coorey), in response to Directors' questions and comments, made the following statement:

> I will first answer the question about whether Zimbabwe has the technical capacity to accurately report reserves, and then turn to the questions in the preliminary statements regarding the Article IV consultation.
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> On the technical capacity issue, we have reached understandings on a template for reserve reporting. We have answered the questions that the authorities had on the template, the underlying methodology, and statistical practices, and are quite confident that they do have the ability to actually deliver these data. These are not complex data. They are fully within the control of the central bank, which could generate such data even on a daily basis if they so wished. Whether they will be willing to actually report international reserves to the Fund is something I find difficult to answer, as that really depends on the authorities' effort and will, but we are quite confident that they are capable of reporting the data as stated in the condition.
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> Directors' questions on the Article IV consultation fell into three broad areas. First, on developments and projections, in answer to the question about the regional impact of economic instability in Zimbabwe, there is no doubt there is an impact on the neighboring countries, but it is very difficult to quantify. The data are very scarce and the activity is largely in the informal market, mainly through trade and labor movements. We have some official statistics. For example, if you look at Botswana's trade data between 2001 and 2006, what had previously been a balanced bilateral trade relationship between Botswana and Zimbabwe shifted to a surplus for Botswana with exports from Botswana to Zimbabwe rising to roughly four times the level of imports from Zimbabwe to Botswana. In other words, there has been a very large net export shift in favor of Botswana. Estimates have been made that roughly 3 million out of 12 million Zimbabweans live abroad, many of them

in neighboring countries. The scale of migration is difficult to gauge, because there is a lot of daily movement, most of it illegal. According to press reports, something like 110,000 Zimbabweans were deported from South Africa in 2006, and further 32,000 from Botswana, but that is just the tip of the iceberg.

On whether the new institutional framework to handle the marketing of platinum, emeralds, and diamonds implies greater government interference in the economy, this indeed does appear to be the case. Our understanding is that the proposed regime would be much the same as that which applies now to gold. The Reserve Bank of Zimbabwe (RBZ) is the sole purchaser of gold. In principle, they would purchase these other precious metals and gemstones and be their sole exporter. Recently, Directors might have read that the President announced that the diamond mining industry would be nationalized, but it is unclear how that would be made into law. We have asked the authorities for clarification as to their intentions and are awaiting a response.

With regard to external financing from nontraditional sources, staff's projections for 2007 are based on financing expected by the authorities from China, Afreximbank, and some commercial banks. The numbers are based on data provided by the authorities on credit agreements that they said were being negotiated or had already been finalized.

A second group of questions related to the authorities' recent policy package. With regard to content, the authorities' reform package is essentially the same as what is described in the staff supplement. The description of the January Monetary Policy Statement is essentially the same package. The key feature is a social contract that involves a price-wage freeze to be followed by a liberalization of the exchange regime, interest rate increases, price deregulations, and a winding down of quasi-fiscal activity.

On the question of the likely effectiveness of these policies, we agree that a social contract could be a useful part of a stabilization package, particularly when it comes to breaking an inflation expectation spiral. The authorities have taken some steps that would be helpful from the point of view of a stabilization package by deregulating maize and wheat prices. However, there are some important missing elements. From the experience of other countries, a social contract is successful when it is negotiated, voluntary, and part of a larger package, usually involving a substantial fiscal adjustment. In Zimbabwe's case, first, the authorities have announced that they intend to start the proposed wage price freeze soon, but much of the reforms relating to exchange rate, interest rates, and possibly fiscal cuts are mainly in the second half of the year, so they actually follow rather than taking place simultaneously. Second, the authorities have made no specific commitments on the size of the fiscal cut—usually in a social contract the government undertakes to also get its house in order in terms of fiscal policy. Third, the labor unions have rejected the wage freeze out of hand, while the business community has been deeply divided on the issue. Recent press reports have suggested that the government may impose the wage-price freeze rather than having it agreed mutually. Fourth, increases in public sector prices are, as I said, a necessary part of a package, but given that most of these prices are input prices, for instance electricity, fuel, and grain, it is difficult to see how these increases are compatible with a freeze on private prices. Either the freeze would be ineffective or the private sector will be driven out of business. Thus, many questions remain on the package.

Staff was asked whether it could confirm several statements relating first to whether the RBZ was refraining from new quasi-fiscal activity (QFA) and whether all QFAs were being transferred to the budget and, second, whether the authorities will liberalize the exchange rate and interest rate and put hard budget constraints on enterprises. On the first, we do not have the data to be able to confirm whether the commitments on quasi-fiscal activities have been carried out in 2007. We have data in the staff report through end-October, 2006. On the second set of questions, the authorities have made commitments in these areas, and we hope very much they will carry them out. The recent increase in the maize and wheat prices is a positive step.

Finally, in response to questions regarding staff's recommendations on the policy package, we agree that any stabilization package would have to be tailored to the case at hand, but there are useful lessons that one can learn from international experience and that apply to the Zimbabwean context. As the staff papers document, the distortions in Zimbabwe's economy are extensive, and the causes for the macro instability are interrelated. They center on quasi-fiscal activity and price and exchange controls, and therefore our recommendations have focused on those areas. The reason these actions should, in our view, be nearly simultaneous, is because when one starts addressing one distortion, it has an immediate impact on another. For instance, inflation cannot be brought down if exchange rate devaluation is not supported by a fiscal tightening. At the same time, because of the large exchange subsidies, fiscal policy cannot be tightened unless the exchange rate is unified, so these actions by their nature have to come together. Staff has emphasized that actions also have to be urgent and comprehensive since, in our judgment, the situation in Zimbabwe, with monthly inflation now above 40 percent, is beyond the point where a gradual or limited effort could work.

With regard to why the comparator country set in staff studies include only two African countries, this is because there were only two African countries, namely Angola and the Democratic Republic of the Congo, that met the cut-off criterion for the sample, i.e., having annual inflation above 1,000 percent between the years 1980 and 2006.

The staff representative from the Policy Development and Review Department (Mr. Fisher) responded to Ms. Phang's question on whether staff could confirm if there were Fund members who, like Zimbabwe, did not fully comply with data reporting obligations on international reserves, but still received Fund technical assistance and were not subject to other actions. He noted that over many years the Fund had provided extensive technical assistance to a large number of members to strengthen their statistical systems, including capacity building exercises in the area of reserve reporting. The nonreporting of reserves as a result of shortcomings in capacity would not give rise for a breach of the Articles of Agreement, thus no action would be taken in those instances in terms of sanctions, rather a cooperative effort would be undertaken to help the authorities build the needed capacity. He added that in the case at hand the authorities were fully capable of implementing the reserves reporting template, which had been extensively discussed in the course of the previous mission. Staff did not believe that additional technical assistance was required.

Mr. Mirakhor made the following statement:

Thank you very much to both of our staff colleagues for their responses. On the first responder, I gather that there are some deficiencies in the social contract approach, but these are not beyond being corrected with the staff's assistance, at least from what we understand about what was reported by Mr. Gakunu and also by the staff itself.

On the second responder, I assume that there are a large number of member countries that are not reporting their reserves to the Fund according to the template because we know the population of Special Data Dissemination Standard (SDDS), which provides for the most complete reporting of such data. Outside of that population, it is safe enough to hypothesize that there is at least a substantial group of member who do not report reserves according to the template. What I am interested in is the legal implication of this decision. We are telling Zimbabwe that we are not going to restore its voting rights because it is not correctly reporting reserves. By that rationale, those other members who are not reporting reserves according to the template could be legally stripped of their voting rights. This is not an absolutely hypothetical question. The history of the institution shows that it is possible for the Board to come to those kinds of decisions, and given our experience and the discussions we have had over the past year on some issues, we know there is political muscle to make decisions in the Board not on the basis of consensus but rather on the basis of a supermajority. Thus, there is a real fear and concern, as a number of our colleagues have eloquently stated, especially Messrs. Kishore, Loyo, and Mozhin, that this is not just about Zimbabwe. It goes way beyond that. The minute this institution decided that it was going to subvert its own legal rules by not restoring Zimbabwe's voting rights it was put in a position of having to make decisions by subterfuge. Nobody outside the institution is going to be fooled by the procedural and technical reasons used to postpone a decision that should have been made sometime ago. It can go on for another year, and there might still be a political decision not to restore a member's voting rights. So, aside from Zimbabwe, I think nobody in this Board is denying the fact that the policies are not good; indeed, they are disastrous, as a number of colleagues have stated. Those policies need immediate attention, but we are not helping in that course of action. We have one condition laid out there that not only will not give Zimbabwe a clear road map forward, as Mr. Loyo was suggesting, it also creates a huge number of concerns on the part of the rest of the membership.

As to your call, Mr. Chairman, and Mr. Shaalan's call for moving forward, we really have to have some basis for compromise. Right now the situation is such that those who would like to make situation much worse both for us and for Zimbabwe are not prepared to move forward. The right way is to go ahead, as was suggested, and immediately restore Zimbabwe's voting rights, as stated by Messrs. Kishore and Loyo and also very eloquently by Mr. Mozhin. Those rights should be restored, but then the Board should insist, just like we do in all Article IV consultations, that policies need immediate correction. The PRGF sanctions will remain in place, so there is no way that the restoration of voting rights is going to suggest that this institution is somehow condoning what is going on in Zimbabwe, rather on the contrary, it is saying that this is a rules-based, cooperative institution and has responsibilities vis-à-vis each of its members.

Mr. Gakunu, on the issue of the wage freeze, said his understanding was that the social contract to be discussed amongst the government, the private sector, and social partners was a proposal by the government and not a decree. Thus, the wage freeze was still for consideration and not yet in place. A negative outcome on the social contract should not be anticipated. Such social contracts had been used in a number of other countries undergoing similar reforming processes to that Zimbabwe was willing to undertake. Furthermore, he agreed with Mr. Mozhin and others that Zimbabwe should not be a test case. It was for that reason that the his earlier statement noted the authorities' recognition of the inadequacy of their policies, but that they did not think it would be appropriate to use such weaknesses as a pretext for not restoring voting rights, as that could have a negative reputational risk for the Fund. In that context, and speaking on behalf of the Zimbabwean authorities, he supported the call of Messrs. Mirakhor, Kishore and Loyo to restore the country's voting rights and for the Board to urge Zimbabwe to put in economy in order with the help of the IMF.

The staff representative from the Legal Department (Mr. Laryea) addressed Mr. Mirakhor's question on whether the proposal would create a precedent for cases where the Board might impose new sanctions on a member for breach of Article VIII, Section 5. He noted that the Board's December 2004 decision with regard to strengthening the effectiveness of Article VIII, Section 5 provided the procedural steps for a graduated imposition of sanctions based upon a member's breach of the aforementioned general obligation. However, those procedures were not pertinent to the case at hand because management's proposal was narrowly tailored to instances where the member had cleared its GRA arrears, but there was a foreseeable concern of a potential future breach of Article VIII, Section 5. As such, the precedent was limited to the context of those specific cases. Of course, to the extent that the Board adopted management's proposal, the policy would have to be applied in similarly situated countries, but it would have no bearing at all on how the Board would deal with an imposition of new sanctions on the member for the breach of Article VIII, Section 5.

Mr. Mirakhor pointed out that the last paragraph of the statement by the Acting General Counsel's on the Limits to the Discretionary Power Given to the Executive Board (BUFF/06/44) determined that the Board could exercise discretionary power on the basis of relevant considerations. He agreed that finding was consistent with historical practice, but believed there was a potential to create serious precedents. He therefore had concerns about the legal opinion that the Zimbabwe case was an isolated one and not applicable to future cases.

Mr. Duquesne made the following statement:

> If my counting is right, we are roughly equally divided in three groups: those in favor of the immediate restoration of voting rights; those wanting to add extra conditions to management's proposal; and those supporting management's proposal. Our Chair was in the first camp, in support of the immediate restoration of the voting rights, a year ago, and we are now accepting new conditions as foreseen in management's proposal.
> Mr. Kashiwagi recalled that he came from the opposite perspective, as he abstained previously, but now also accepts management's proposal. If I am permitted to say so, I believe we are both demonstrating our desire for compromise. Therefore allow me to make a plea to the two other groups, because I do not see what kind of reasonable compromise we could have except what is on the table today.

To the group in favor of immediate restoration of voting rights, I will simply say that if we do not decide today, we will be in the same situation in a year's time, so what you hoped to avoid will indeed come to pass. To the group wanting to add conditions to what is proposed today, I reiterate that surveillance should be used toward that end. I do not know if we can invent a mechanism for enhanced surveillance. My suggestion would not be to have another report on the question of voting rights in three-to-six months, but rather to discuss a report on the economic situation—a kind of interim Article IV consultation—and to monitor closely the economic situation and policies of the country. We could be very blunt—more than usual—in the messages we convey to Zimbabwe. I hope we can gain sufficient support for management's proposal from the two other camps for a yes vote today. This is why I slightly disagree with my esteemed colleague Mr. Kishore. I am ready to vote today, and I am ready to vote today even if we do not have 70 percent. The two stage restoration strategy does not mean we need 70 percent today. We need 50 percent. I hope that in the meantime some views might change a bit or the country also might change a bit. The two stage strategy calls upon everyone to demonstrate a commitment, and you have to graduate from 50 to 70 percent of Directors in support. It would not be very difficult to reach a simple majority if in both camps some colleagues would move.

Finally, like Mr. Mozhin, I fully agree with the idea that we are not discussing Zimbabwe. The name of the country could be replaced with any country. We are discussing the legitimacy and efficiency of the IMF. Those wanting to be very rigorous with Zimbabwe, even assuming that they are not discussing politics but really talking about economic policy, are diminishing the Fund's power going forward with respect to other countries. Thus, we are not really discussing the future of Zimbabwe, as said Mr. Mozhin, but to a certain extent the future of the Fund.

Mr. Mirakhor agreed with Mr. Duquesne that the discussion was not only about Zimbabwe, but also the legitimacy and efficiency of the IMF. He noted that some Directors had clear concerns for the integrity and credibility of the institution. A year ago management, supported by the Legal Department, had come to the Board suggesting Zimbabwe's suspension should be lifted and voting rights restored immediately. However, the new proposal indicated that the Fund was no longer prepared to restore the country's voting rights. It was hard to imagine that outsiders would not see through what was going on, undermining the legitimacy of the Fund, despite the possibility that the proposal might turn out to be the most expedient approach. In that light, he suggested that it was Mr. Duquesne's group that should consider joining those in support of immediate restoration, thus proving the integrity and credibility of the IMF.

Mr. Duquesne recalled that at the previous meeting on Zimbabwe support for immediate restoration of voting rights fell just shy of 50 percent, including the support of his own Chair. It was therefore realistic to expect that management's proposal could obtain the necessary support if some Chair's shifted their views, but immediate restoration was something that had already been attempted and failed.

The Acting Chair (Mr. Kato) clarified that the proposal sought Board approval of management's draft letter to the Zimbabwean authorities, which required a simple majority of Directors, but the immediate restoration of voting rights required a special majority of 70 percent.

Ms. Phang completely agreed with Mr. Mirakhor. She appreciated Mr. Duquesne's remarks and his efforts to build consensus, but stressed that the letter was not a solution for Zimbabwe. It merely told the authorities what was needed in order to comply with the Fund's reporting requirements, without assuring them that once they fulfilled that condition that 70 percent of the Board would agree to restore voting rights. As a rules-based institution, the IMF should have already restored those rights when the original issue that gave rise to the sanctions was remedied. She agreed with Mr. Mirakhor that over the last few years it appeared that the Fund was becoming politicized, as evidenced by the discussion on the 1977 surveillance decision, which was initiated at the behest of a few members. Certainly, nearly every Chair disagreed with Zimbabwean authorities' economic management, but that should be dealt with through Article IV consultations and program conditionalities in order to put the economy back on the right track. The issue of voting rights was a separate matter, and the compromise was no compromise at all, because there was no assurance that those rights would be restored.

Mr. Prader fully agreed with Mr. Duquesne and supported his call for a pragmatic approach toward consensus. He shared the concern raised by Messrs. Mirakhor, Loyo, and Mozhin. He did not feel that it was appropriate to make restoration conditional on accurate reserve reporting, because such conditions had not been placed on other members who had repaid arrears to the Fund. That said, if the proposal could garner support from those previously opposing the restoration of voting rights, then it could be acceptable. It was clear that more was at stake than just Zimbabwe's status with the Fund, because in such situations the Fund's credibility was on the line. It was disappointing that the proposal had not garnered more support from the group that it had intended to conciliate, namely those Chair's against the restoration of voting rights and calling for additional conditions, with the exception of Mr. Kashiwagi, and those members were asked to reconsider their opposition. In that regard, Messrs. Mirakhor, Loyo, and others had misunderstood the purpose of the proposal, as it was not them who were under attack, but rather it was intended as a way to find support from those against the immediate restoration of voting rights.

Mr. Loyo remarked that he had not misunderstood the purpose of management's proposal. He did not consider it as a mere attempt to save face, and reiterated his view that it seemed to be a good faith effort to make the conditions as simple, nononerous, and as close as possible to the unconditional version that many had favored. That aside, the particular choice that was made was not a fortunate one for the reasons he provided earlier. Focusing on an issue on which Zimbabwe did not stand out from many other cases of reporting problems would not help allay the fears voiced by many that it would create an dangerous if not a legally-binding precedent. To the outside world, it would appear as if the Fund was procrastinating, using a legal or technical subterfuge to avoid doing what it was compelled to do—immediate and unconditional restoration of voting rights. He disagreed with Mr. Duquesne and felt it would not do much good to vote on something that all parties agreed would not ensure an eventual restoration of voting rights. While taking into account staff's good faith efforts to find a middle ground, since the proposal at hand was not satisfactory, he again called for a road map of the way forward.

Mr. Sadun made the following statement:

> All Executive Directors have either issued a preliminary statement or have otherwise stated their position. I think that we all have stated our principles as well, but now we are faced with a situation, and it is clear that the three possible alternatives, as they stand right now, do not command the majority of the Board. I think that we have to make some step forward in trying to deal with the situation with realism and a spirit of cooperation. The realism that is necessary has to start from the conclusion that an immediate restoration of Zimbabwe's voting rights does not seem to have any realistic chance of being adopted because of the high qualified majority required. This is a consideration that we cannot escape, at least not today.
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> Secondly, I am sure that my colleagues who have already invoked the spirit of compromise do not have in mind that the only way to demonstrate the spirit of compromise is to ask the other sides to come to their position. It seems to me that the only realistic compromise is to support management's proposal. It is not an ideal proposal, but considering how things stand right now, it is probably the best way to move forward.
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> I am very encouraged by Mr. Duquesne's position, which clearly indicates his willingness to compromise. He has not been the only one to show flexibility, given Mr. Kashiwagi's position. If I may remind the Board, we have also modified our position since the last Board meeting. I think that is the right direction in which we should move.

I also listened with great attention to the assurance that we have received from the Legal Department on the implications of the decision. I am fully satisfied on the basis of their clarification that, if we are going to accept the Managing Director's compromise, we are on very solid legal ground. I believe that what we are discussing here is a situation that must be resolved with realism and sense of compromise. We are faced with a very specific case in which one of our members has undertaken misguided policies that almost all of us are criticizing. One of the issues here is a lack of cooperation, and there are degrees in that regard, but I fully subscribe with what, for instance, Mr. von Stenglin said on the scope and depth of Zimbabwe's noncooperation as clearly standing out. Therefore, it is up to the country to bear the burden of proof that they want to change. I think that is the first step. As a precondition they should be required to demonstrate concretely that they want to significantly improve their relationship with the Fund and the international community. I believe the Managing Director's proposal will allow them to do such.

I have noted with great interest in the preliminary statement by Mr. Mirakhor that he pointed out and congratulated staff's readiness to intensify their discussions in response to any positive policy scenarios from the authorities. I believe that the Managing Director's proposal provides the Zimbabwean authorities with exactly that opportunity. They should not miss out on it and we should move forward.

Mr. Kashiwagi made the following statement:

First, I would like to support what Mr. Mozhin has mentioned and echoed by many Directors that we are not discussing Zimbabwe today; I think we are discussing the IMF itself. For this Chair, restoring the voting rights of Zimbabwe is an important issue, but restoring the credibility of the Fund is much more important. I appreciate Mr. Duquesne's acknowledgement that our Chair has shifted its position compared to that of a year ago in the spirit of compromise. I agree with him that the two groups that are opposing management's proposal today should seek to compromise so that we can agree on one single proposal. At the same time, I think Board members have noticed that our Chair has always been undogmatic and taken a very pragmatic view on this and other issues. Today, I would like to express our view that we could be more flexible in that sense.

> I was very interested in listening to Mr. Kishore's statement several minutes ago. I may have misunderstood some of the points he made, because if you listen to something you always hear what you want to hear, but I think we all need to recognize that there is a need to restore the voting rights of this country as soon as possible. Policy change should not be a precondition, but could be specified in some kind of letter. As regards reserve data submission, whether this occurs every one month or bi-monthly, I think we can be very flexible and we are ready to compromise on those points. However, it seems that the original proposal of management is not going to find a simple majority. We are in a stalemate, and this Chair is very concerned about this stalemate, because the Fund's credibility is on the line. If we are able to compromise on a revised letter, I think that would be very fortunate and we should pursue that route.
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> Mr. Chairman, as you noted, restoration of voting rights requires a 70 percent special majority, and I do not think realistically speaking 70 percent is possible today. However, if we can get 50 percent on a revised letter, thereafter we could schedule another Board meeting soon to try to reach a 70 percent majority on some sort of compromise. As I said, this Chair wants to look at things in a very pragmatic way. I want to express our flexibility and willingness to listen to others on this point.

Mr. Saarenheimo noted the many calls for compromise, but a general lack of inclination to change views. He supported Mr. Kashiwagi's remarks, and said his Chair would be willing to join any emerging compromise, but he was not hopeful that a compromise was possible in light of the concerns raised by those Chairs that called for an immediate restoration, as their argument were based on a point of principle. It was clear that a vote on immediate restoration of voting rights would not achieve the requisite support, nor was the Board in a position to offer a binding commitment on a timeframe for such a restoration. Of the suboptimal alternatives available, the default position was to take no decision, and for management to write a letter to the Zimbabwean authorities without the Board's endorsement. The letter would inform the authorities that close to half of the Board supported immediate restoration, and an additional three Chairs would support the restoration of Zimbabwe's voting rights if the authorities were to accurately report foreign exchange reserves for a period of time. However, Chairs accounting for approximately one-third of the total voting power wanted further actions and might be persuaded to join the others if during the coming months the Zimbabwean authorities demonstrated a determined effort to improve policies. On that basis, there would be hope that in 12 months time, or possibly sooner, there would be sufficient support to restore Zimbabwe's rights. Such a move would not reflect well on the Fund, as it would reveal its indecisiveness, but it would avoid creating a precedent, and it was hard to see any alternative.

Mr. Loyo thanked Mr. Saarenheimo for his important intervention. He agreed that the critical issue was not the timeframe for reporting reserve data. He also agreed that it was hard to conceive of a better outcome than that described by Mr. Saarenheimo. While it would not be decisive, it would be an accurate portrayal of the Board's division on the issue, and the Zimbabwean authorities would have a formal statement of what has happened. It was up to the authorities to choose their own path going forward. The Board would reconvene at another time to see if on the basis of new information views change.

Mr. von Stenglin expressed a degree of sympathy for the arguments put forward by Messrs. Mirakhor, Mozhin, and others, but assured the Board that his Chair did not easily adopt its position on the issue and did not intend to politicize the Fund's actions, as it was convinced of the importance of a rules-based approach and the principle of equal treatment. As pointed out in his preliminary statement, while sanctions had not be imposed in other cases of noncompliance with obligations under the Articles of Agreement, Zimbabwe was an extreme example of noncooperation demanding a higher standard for the restoration of voting rights. After having heard and read all the arguments brought by Mr. Gakunu and others, he was still not convinced that the proposal sufficiently addressed Zimbabwe's cooperative deficiencies. However, to overcome the gridlock, he offered to abstain on the decision should that facilitate achieving a majority. He was also willing to go along with the proposal by Mr. Saarenheimo to leave the issue undecided for the time being.

Mr. Raczko thought that the Board should focus on the issue of restoring voting rights in line with what was required under the Articles of Agreement. The staff's proposal was consistent with what the Fund was legally required to put forward, which is why his Chair had shifted its position to support staff. The major problem appeared to center on conditionality. From a legal point of view, the Board could at its discretion impose such conditions for the restoration of voting rights, which in this instance was necessary given the situation in Zimbabwe. A positive signal was needed from the authorities that they were indeed willing to cooperate with the Fund to improve the economic situation. He noted that Mr. Mirakhor and others suggested that the Board should immediately restore the country's voting rights and then send a signal on what was expected, but the Board might not be willing to take such a risk in light of the possibility that Zimbabwe's economic policies could worsen. Thus, he called on his colleagues to reconsider conditionality. His Chair was prepared to be flexible in that regard, but a signal needed to be sent to the authorities.

Mr. Kishore assured Mr. Kashiwagi that he had understood his remarks correctly. He noted the widespread willingness to move forward on the issue and the need to compromise in order to break the stalemate. The strength of the Fund was cooperative engagement, rather than the voting power of its individual membership. He proposed that the Board authorize the Managing Director to address a letter immediately to the Zimbabwean authorities stating the Board's intent and willingness to restore its voting rights at the earliest possibility. He felt the timeframe should be shorter than foreseen by the proposal, in the event the authorities could deliver on their commitments.

Mr. Mirakhor, referring to Mr. von Stenglin's earlier remarks on cooperation, pointed out that paragraph 7 of the staff's report on the Restoration of Voting and Related Rights (EBS/06/25) determined that, "with the full clearance of GRA arrears, the test of cooperation on policies would no longer be relevant in measuring the objective that has been met, and should not be a residual factor in determining whether to lift remaining sanctions imposed under the Article XXVI, Section 2 in the circumstances of Zimbabwe." Thus, noncooperation on policies as a basis for not restoring voting rights was inconsistent with the Articles of Agreement.

Mr. Prader expressed support for Mr. Kashiwagi and his response to Mr. Kishore's compromise and offer of flexibility. He felt it looked bad for the Board to merely send a letter to the authorities summarizing the split views, given that the strength of the Board was its ability to build consensus. The evident disunity across the Board was a serious concern, particularly the silence of some Chairs opposing the proposal. If it proved impossible to come to an agreement, the Board should reconvene at a later date to discuss a more flexible proposal which, after a period of reflection and soul searching, might produce a majority.

Mr. Rutayisire remarked that a proposal should ideally command a 70 percent majority to assure the Zimbabweans that their voting rights would eventually be restored. He felt the Board was still far from such a consensus, and there was a need for movement all sides. While he could not speak for other Directors with views similar to his own, he felt he could support management's proposal if there was a guarantee that Zimbabwe's voting rights would be restored after 12 months.

Mr. Murray commented that two hours of discussion had yielded a great deal of talk about principle, particularly from those calling for the immediate restoration of voting rights. While clearly understand that position, and noting that there was no consensus view within his own constituency, he rejected any implication that his opposition to immediate restoration was unprincipled. As Mr. von Stenglin stated, Zimbabwe was an extreme example of noncooperation, in addition to being in breach of multiple obligations under the Articles of Agreement, making it a very unique case. His Chair did strive to build a consensus, but the uniqueness of the case posed an obstacle. In that sense, the issue under discussion was Zimbabwe, and not the Fund itself. He felt that the best possible outcome was Mr. Saarenheimo's suggestion for a management letter. The onus was not on the Fund to find a solution, but rather on Zimbabwe to find one.

Mr. Loyo assured Mr. Murray that he was not implying that his position was lacking in principle. He clarified that his Chair was supporting the principles that it considered the appropriate basis for Fund policy. Others might consider different principles as the foundation for Fund policy.

Mr. Shaalan disagreed with the contention of Messrs. von Stenglin and Murray that Zimbabwe, as an extreme case of noncooperation, should not have its voting rights restored. It was an unprincipled position that would hurt the Fund . He was particularly concerned that the Board was not abiding by long-standing principles and was not prepared to address the consequences of a decision not to restore voting rights. He suggested that the Board adjourn and reconvene once Directors had an opportunity to reconsider.

Mr. Murray agreed with Mr. Shaalan on the need to adjourn. He assured Messrs. Shaalan and Loyo that his Chair believed its position to be well-grounded in principles in terms of the rules-based character of the institution and in terms of evenhandedness.

Mr. Ladd made the following statement:

> I just wanted to associate with Mr. Murray's point that this is about Zimbabwe and not necessarily about the Fund. There are consequences for the Fund on every decision we take. This is not positive or negative. This particular issue does not distinguish itself from all the others we deal with in that respect. Zimbabwe, by running into arrears, has gotten itself into a trap that is very difficult to escape, given that I do not think that the bulk of the voting power of the membership feels that membership in a voluntary institution should be a revolving door.
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> I take heart from Mr. Gakunu's assessment that the authorities get it now. However, their voting rights, whether they are restored or not, are immaterial to them pursuing that agenda, if they so choose. It is quite possible they may still be completely unrepentant, so I am not sure what praise for Zimbabwe by restoring their voting rights would do to the image of the Fund under the circumstances.
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> I fully understand the position of those who continue to call for the immediate restoration of voting rights. I would never expect those who called for the immediate restoration of voting rights in March 2006 to endorse anything in the Managing Director's proposed letter. I think they are approaching the issue from an equally principled and well meaning perspective, but with a somewhat different understanding about the relative priority of the principles on which the Fund operates.

Those of us who opposed immediate restoration at the time were quite explicit about what problems we had with Zimbabwe. For the most part, we endorsed the summing up that was issued at the time. Frankly, that is where the staff should have started in terms of what they put to the Managing Director, because it has put him in a very awkward position now. No consideration is extraneous at a time like this. The Board has to take everything into account.

I wanted to address the concerns about whether or not our position is consistent with the principle of uniformity of treatment. I am sure if there were ever a comparably poor performer who violated the Articles of Agreement and ran into arrears, they would be treated comparably. I also accept that Zimbabwe's foreign exchange reporting is not particularly outrageously bad, but this is why the Managing Director's letter is not a good foundation for going forward. In that respect, I agree with Mr. Loyo, although we reach rather different conclusions. The restoration of Zimbabwe's voting rights at this point is certainly immaterial to whether or not Zimbabwe implements a sound economic policy agenda. Similarly, considering their weight in the voting power of the Fund, it is unlikely to have any impact on the outcome on our decision-making here in the Board for the foreseeable future. However, restoration of their voting rights at this point would be somewhat unfair to all the low-income countries that have made enormous sacrifices over the years to pay their GRA and PRGF obligations in full and on time, so I do not really see where the image of the Fund would benefit in that respect.

Under the circumstances, and having heard the views expressed by Mr. von Stenglin and Mr. Sadun, I could only say we are probably more comfortable with our position in expressed in our preliminary statement now than we were before the Board meeting. We look forward to hearing the Managing Director's reactions to our deliberations this morning.

Mr. Gakunu made the following statement:

Mr. Chairman, I just wanted to touch on a few issues that have been raised by the last statement that I found not to be factually correct.

First, I think the Board has been trying very hard this morning to distinguish between voting rights and the policies of Zimbabwe. I think there has been a unanimous opinion in that regard, including that of this Chair itself, that the policies being implemented by Zimbabwe have not been appropriate. However, the fact that their policies are out of sync with the rest of the membership is not a condition for restoration of their voting rights. Zimbabwe does not have any more outstanding GRA arrears, which the staff has clearly indicated. There are only outstanding arrears to the PRGF-ESF Trust. I have agreed with those Chairs that have said that Zimbabwe needs to implement the appropriate measures to address those remaining PRGF arrears in order to be in good standing with the Fund. I think there is no misunderstanding in that regard. We understand very clearly that the policies that the Zimbabwean authorities have been pursuing have not been the right ones, and that is why they have decided to develop a social contract, as has been done in other countries.

Second, the staff in their report have clearly indicated that they cannot say whether the authorities' reserve reporting in any way violates any of the requirements of the Fund. In footnote 6 on page 2 of the report, the staff states that "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." Thus, the issue of reserve reporting that is coming now is anticipating that, on the basis of the new reserve reporting template supplied by the Fund, Zimbabwe may become in breach of its obligations, and not that Zimbabwe has misreported or not furnished appropriate data. In that light, I would urge again, Mr. Chairman, that those Board members arguing for the immediate restoration of Zimbabwe's voting rights understand what Zimbabwe must do thereafter in order to be a member in good standing fully with the Fund. I thought I should highlight these points based on the last intervention.

Mr. Duquesne remarked that, aside from those accepting management's proposal, and the flexibility demonstrated by a small group of Directors who had been in favor of immediate restoration of voting rights, e.g., Messrs. Rutayisire, Kishore, and Prader, he was struck by the silence of those strongly opposing management's proposal and the lack of flexibility of those who had spoken. He was ready to join Messrs. Kashiwagi and Prader in their support of Mr. Kishore's proposal. If all those accepting management's proposal and those supporting the immediate restoration of voting rights were to coalesce around Mr. Kishore's proposal, it would achieve the required majority. He felt the Board should not procrastinate on the matter, because if they were unable to come to a decision it, then there was a danger it would drag on.

Mr. Larsen made the following statement:

I have kept silent so far and listened to the various arguments put forward and have been particularly encouraged by the recognition that you can be principled in more than one way. The principle upon which we based our position concerns noncompliance with the Articles of Agreement. One has to be careful about what terms are used, but noncompliance is a very specific term. We are not talking about noncooperation, economic performance, or any broader concept, we are talking about noncompliance with the Articles of Agreement. It is in that sense that we think management have set the standard in the wrong place. If we adopt this approach, we might even end up restoring voting rights based on judgments and assessments rather than the automaticity that would come about by immediately restoring voting rights without any conditions. We would then be sending a positive signal about the Fund's assessment right at a time when policy was deteriorating. More importantly, compliance with the Articles of Agreement was deteriorating as well. Thus, we have not supported management's proposal.

There is clearly a deficiency in our sanctions policy. It is very difficult to see how we are going to deal with this case. What should be the procedure for de-escalation? Is it supposed to be automatic? If so, why does the policy not say so? If not, then it should say so explicitly, and we could then make our judgment on that basis. Like others, we take the issue of equality of treatment very seriously. As soon as you permit a degree of adjustment, as is implicit in our approach, there will be uncertainty, and we will have to move very cautiously. We recognize that creates concern. I would have more confidence in the Board than I hear others expressing today. I think the key issue here, as Mr. von Stenglin put it precisely, is the sense that Zimbabwe does stand out for falling short in several areas, including as regards compliance with the Articles of Agreement, and has shown no serious intent to address these shortcomings. Instead, the authorities have chosen a policy path that at least in the eyes of this Chair seems to imply an aggravation rather than an alleviation of the breach of the Articles of Agreement. To our mind, the Board has not been confronted with a case like this before, and I hope that we will not be confronted with another one soon. As Mr. Murray stated, I do think that Zimbabwe is the issue at hand. It is a truly unique case, and it is not about changing our approach.

As for how we move forward from here, I can agree that both the Board's and the Fund's credibility are at stake. It is probably not a good idea to make a promise that the Board cannot subsequently deliver. I hope we have set our views out clearly; at least as it stands now, we will not be voting for restoration of Zimbabwe's voting rights on the basis of management's proposal. As to how we move this forward from today, we will be listening with an open mind to proposals from management.

Mr. Kaplan made the following statement:

Just at the outset, let me say that we stated our position, I thought, very clearly in our preliminary statement, and certainly the number of interventions that we might have or the sheer volume of words is not correlated with the strength of feeling that we have on the issue. That said, we did listen quite carefully to the range of views that were presented today.

There have been a number of terms used today: the legitimacy or illegitimacy of the Fund; and principles, who has them, and who does not. I just want to make a few points clear. We share the logic that was best expressed by Mr. von Stenglin in the sense that we have a country that is almost beyond the pale. It is clearly a unique case, and as just articulated by Mr. Larsen, one whose economic policies are not only inimical to the purposes of the Fund, but whose actions appear almost in direct opposition to any good advice or any wise counsel that they may receive.

I would like to reiterate that our view of the staff's work on this country is highly favorable. The staff's advice, and the analytical work behind that, is absolutely of the highest caliber. We understand very much that the work in Zimbabwe is difficult, not least due to the context of the Board discussion that we are having today.

As for the matter of principles, legality, what is changing rules in the Articles, and what is breaking rules in the Articles, we just wanted to make clear our assumptions. We certainly take the point that the Board has the legal ability to restore Zimbabwe's voting rights. It is also fair to say that, based on the management's own proposal, the Board has the legal ability to require compliance with other Articles that Zimbabwe is not currently conforming with, or may breach in the future. The imposition of a condition as regards Article VIII, Section 5 is certainly legal. Mr. Larsen and Mr. Williams made an interesting proposal that tied the restoration of voting rights to other Articles of which Zimbabwe is currently in breach. Without committing to that exact proposal, we certainly presume that since those are similar breaches of the Articles, the Board would be completely within its rights under the Articles to require compliance. I do not think there should be any question about the legal rights or principles on which some members of the Board are acting.

There is a question on whether the Board should be requiring a level of cooperation on policies. This is a policy matter. We believe that there should be compliance with economic policies, as well as arrears payments. Looking back at the precedents, for example, the Democratic Republic of Congo was cooperating with the Fund on policies, implemented a Staff-Monitored Program (SMP), and repaid its arrears prior to restoration of its voting rights. We have the case of Sudan, still unfortunately in arrears, but cooperating with the Fund on a series of SMPs. As a result, economic cooperation was deemed adequate by the Board as a whole, and its voting rights were restored. It is our hope that in the short term we will return to the issue of Liberia's voting rights. It still has arrears, but its cooperation with the Fund on economic policies in the form of the SMP is outstanding. As we have discussed recently, they should have an upper credit tranche program if not for the inability of the Board to decide on a prompt and proper arrears clearance strategy.

I do not want to say much more than what we articulated in our preliminary statement. Members have differences of views on this issue. They are fully principled, and it is absolutely fair to say each Director that is here and the constituencies that they represent want only the best for the people of Zimbabwe. They have different views on how that should be accomplished.

The Acting Chair (Mr. Kato) concluded that the proposed letter from the Managing Director to the Zimbabwean authorities outlining the conditions to restore voting rights did not command sufficient support for the decision to be taken forward. He noted the issue continued to be a difficult one, but appreciated the lively engagement on the part of the Board, and the flexibility shown on the part of some Chairs. A number of potential ways to move forward had been floated, and those possibilities would be explored. With regard to the second proposed decision relating to the overdue financial obligations to the PRGF-ESF Trust, he noted there was sufficient support to approve the decision.

The Acting Chair (Mr. Kato) made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They expressed deep concern over the sharp deterioration of economic and social conditions during 2006 because of poor policies and weak governance. Rapidly accelerating inflation has reflected mainly excessively high public spending and deficits, including quasifiscal activities. High inflation, contracting output, and price distortions, particularly relating to the exchange regime, have led to the emergence of acute shortages in basic consumer goods and essential inputs. Directors regretted the deterioration in social welfare, as signaled by indicators on health, and on child welfare and malnutrition, and urged the authorities to promptly address these needs. They called upon the authorities to prioritize government spending to ensure food security, a rapid improvement in the health infrastructure, and well-targeted social safety nets to protect the poor and address the needs of those affected by HIV/AIDS and "Operation Murambatsvina."

Directors warned that without a fundamental change in policies, the crisis will deepen further. They considered that the recently announced policies, which lack upfront action to lower the fiscal deficit and liberalize prices, including the exchange rate, will not reverse the situation.

Directors urged the authorities to implement, without delay, a comprehensive and credible policy package to stabilize the economy. Such a package should comprise mutually reinforcing actions centered on fiscal tightening, and price and exchange regime liberalization. Directors cautioned that the social contract proposed in the Monetary Policy Statement, which would entail a private sector price and wage freeze, would likely be unsuccessful and would not address the fundamental causes of the crisis.

Directors stressed that strong fiscal adjustment is essential. They observed that the 2007 budget, which increases government spending substantially in real terms and does not credibly lower the substantial quasi-fiscal activities expected to be transferred from the Reserve Bank of Zimbabwe (RBZ), falls substantially short of the required adjustment. A reduction in the adjusted primary deficit (incorporating quasifiscal activities) by about 10 percentage points of GDP, as part of a comprehensive policy package, will be needed to lower annual inflation to the authorities' objective of about 450 percent by end-2007.

Directors stressed that the comprehensive policy package should also unify the exchange rate and remove restrictions on current international payments and transfers. As a first step, a single official exchange rate should be established without delay and moved steadily toward market-determined levels. Concurrently, price controls should be liberalized and hard budget constraints imposed on public enterprises, whose losses have been largely responsible for the RBZ's quasifiscal activities. Taken together with the establishment of a strong monetary anchor, these actions will support the RBZ in implementing its core function of ensuring price and financial system stability.

Directors welcomed the measures taken by the RBZ to strengthen banking supervision, especially through a new risk-based framework. They warned, however, that banks profits are declining in real terms and that banks face significant liquidity risks owing to the frequent ad hoc changes to interest rates and the substantial bank assets tied up in illiquid instruments, including government and RBZ bills bearing highly-negative real interest rates.

Directors emphasized that achieving sustained growth will require comprehensive structural reform over the medium term in a number of key areas including, public enterprises, the civil service, expenditure management and taxation, the central bank, land and agriculture sector, governance, and trade liberalization. They cautioned against the proposed new legal arrangements for platinum, emeralds, and diamonds that seem to be establishing public monopolies for exports of these minerals.

Directors encouraged the authorities to improve relations with the international community—including reaching understandings on settling financial obligations—to support reforms and facilitate progress toward the Millennium Development Goals.

It is expected that the next Article IV consultation with Zimbabwe will be held on the standard 12-month cycle.

Mr. Loyo encouraged the Acting Chair to pursue Mr. Saarenheimo’s suggestion. Although it would have to be reviewed in terms of legal and policy implications, he felt it was a constructive and promising avenue in order not to leave Zimbabwe in the dark. Mr. Gakunu would naturally inform the authorities about the content and outcome of the Board discussion, but a more formal and public statement by the Fund would benefit both the Zimbabwean authorities and the rest of the world by explaining the actual state of affairs.

Mr. Gakunu emphasized that the frank messages sent by Directors through their statements were very clear. Zimbabwe needed to improve its economic policies, and that message would be conveyed to the authorities in as direct a fashion as possible. He thanked Directors, management, and staff for their engagement with Zimbabwe, because it was in a difficult situation. As Mr. Mozhin had said, Zimbabwe was not really the issue, rather the issue was the Fund’s accountability. He was grateful to Mr. Kishore for trying to find a common ground. He also thanked Messrs. Saarenheimo, Prader, and Duquesne for the efforts to rally support behind a decision that would be credible not only to Zimbabwe but to the international community as a whole. Like Mr. Loyo and Mr. Mirakhor, he hoped a recess would offer management an opportunity to narrow the very divergent views. It would not do the Board any good to continue to be divided on the issue, and possibly management could privately engage Board members with a view toward ensuring a firm decision at the next meeting.

The Acting Chair (Mr. Kato), in response to Mr. Loyo, reiterated that a number of useful ideas had been floated in the course of the Board meeting and management would reflect upon them.

Ms. Phang was struck by the unrealistic nature of some of the recommendations in the summing up. She wondered whether it was necessary to urge the authorities to immediately move to a unified exchange rate, given that it was more likely that the issue would be addressed in a step-by-step fashion.

Mr. Ladd noted that Mr. Gakunu had heard him say that Zimbabwe was still in arrears to the General Resources Account. He clarified that his Chair was aware that those arrears had been repaid in full in March 2006, which was appropriately recognized with the withdrawal of the Managing Director's complaint.

Mr. De la Barra suggested that wording be added to the summing up indicating when the Board would reconvene to take up the voting rights matter once again, e.g., during the next Article IV consultation.

The Acting Chair (Mr. Kato) replied it was hard to say when they might return the issue. The Board and management would need time to clarify their positions. As soon as management sensed that it could achieve the required majority, it would return to the Board.

Mr. Murray asked for management's assurance that it would reconvene of the issue before 12 months had elapsed. He noted that at the March 2006 management had undertaken to return to the Board in short order to discuss the terms of the letter, but that it had taken 12 months for the meeting to occur.

Mr. Duquesne supported Mr. Murray remarks, but feared it would be another 12 months time before they returned to the matter. He felt that the Board had missed an important opportunity.

Mr. Gakunu acknowledged that both staff and management had tried to build support for some compromise outcome. He felt that the Board would be able to find a compromise if members could cast aside political considerations, but it unfortunately appeared that political issues were becoming more important than the issues that really needed tackling. Management should therefore try to manage the politics behind the scenes rather than bring them onto the Board floor.

Mr. Kashiwagi was surprised by Mr. Murray's request for assurances that the Board would reconvene in less than 12 months time, because it was not management's problem. Management had provided a proposal, which some supported. If those who opposed the proposal were to change their position, then it would be possible to reconvene very soon, so the timing of the next meeting was really their responsibility.

The Executive Board took the following decision:

Overdue Financial Obligations—Poverty Reduction and Growth Facility-Exogenous Shocks Facility Trust

1. The Fund has again considered Zimbabwe's overdue financial obligations to the PRGF-ESF Trust.

2. The Fund notes that Zimbabwe has been in continuous arrears to the PRGF-ESF Trust since February 2001 and regrets that its arrears to the Trust have increased further since the last review. The Fund attaches the highest importance to Zimbabwe's prompt settlement of its arrears and urges the authorities to take action to discharge these arrears as soon as possible.

3. Zimbabwe's economic crisis calls urgently for implementing a comprehensive policy package comprising several mutually reinforcing actions: terminating all new quasi-fiscal activity by the Reserve Bank of Zimbabwe and transferring existing quasi-fiscal activity transparently to the government budget; substantially tightening fiscal policy; unifying the exchange rate and eliminating exchange restrictions with respect to the making of payments and transfers for current international transactions; liberalizing prices and imposing a hard budget constraint on public enterprises; establishing a strong nominal anchor; and undertaking fundamental structural reform, including public enterprise and civil service reform, strengthened property rights, and improvements in governance.

4. The Fund will again consider Zimbabwe's overdue financial obligations to the PRGF-ESF Trust within six months of the date of this decision. (EBS/07/15, 2/14/07)

Decision No. 13877-(07/16), adopted
February 23, 2007

APPROVAL: April 11, 2007

SHAILENDRA J. ANJARIA
Secretary