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0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/153

3:00 p.m., October 12, 1988

R. D. Erb, Acting Chairman

Executive Directors

Alternate Executive Directors

Dai Q.

J. M. Jones, Temporary
C. Enoch

M. Massé
Mawakani Samba

A. Rieffel, Temporary
L. Hubloue, Temporary
E. C. Demaestri, Temporary
M. B. Chatah, Temporary
B. Goos
D. V. Nhien, Temporary
L. M. Piantini, Temporary

C. V. Santos
P. Pérez, Temporary
C. Noriega, Temporary
S. Guribye, Temporary
G. Serre, Temporary
G. P. J. Hogeweg
C. Y. Legg, Temporary
M. A. Hammoudi, Temporary
L. E. N. Fernando
N. Adachi, Temporary
S. Appetiti, Temporary

L. Van Houtven, Secretary and Counsellor
C. E. Wahlstrom, Assistant

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Financial Obligations - Report and Complaint
Under Rule K-1 and Notice of Failure to Settle
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ACAD

85117 951204
781-3 1008Also Present

IBRD: N. M. Gorjestani, South-Central and Indian Ocean Department.
African Department: E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director; M. G. Fiator, G. B. Taplin, E. van der Mensbrugge. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; B. Delbecque, J. H. Felman, R. G. Kincaid. Fiscal Affairs Department: M. Katz. IMF Institute: L. Mawaka, Participant. Legal Department: H. Elizalde, A. O. Liuksila. Treasurer's Department: T. Leddy, Deputy Treasurer; J. E. Blalock, P. J. Bradley. Advisors to Executive Directors: M. Eran, M. Pétursson. Assistants to Executive Directors: J. Gold, K. Kpetigo, J. K. Orleans-Lindsay, D. Saha, R. Wenzel, K. Yao.

1. ZAIRE - 1988 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINT UNDER RULE K-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS, AND REPORT AND COMPLAINT UNDER RULE S-1

The Executive Directors continued from the previous meeting (EBM/88/152, 10/12/88) their consideration of the staff report for the 1988 Article IV consultation with Zaïre (SM/88/210, 9/6/88) and their substantive consideration of the Managing Director's report and complaint under Rule K-1 and notice of failure to settle Trust Fund obligations, and the report and complaint under Rule S-1 (EBS/88/195, 10/7/88; and EBS/88/189, 9/2/88). They also had before them a background paper on recent economic developments in Zaïre (SM/88/220, 9/23/88).

The staff representative from the African Department remarked that on page 20 of its report the staff had noted that "according to the agreed-upon projections, including projected debt relief, Zaïre was in a position to meet its external debt obligations in 1988." However, that statement was implicitly based on the assumption that Zaïre would have a Fund-supported program, and those projections had been made in June, and did not reflect developments since then. Thus, the staff could not say whether or not Zaïre was in a position to meet its obligations to the Fund; the staff did not yet have complete information on Zaïre's cash position.

The medium-term scenario on page 22 of the staff report also was based on the assumption of debt rescheduling on exceptional terms, as had been arranged in 1987, the staff representative explained. The formulation of the scenario also had preceded the Toronto summit initiatives as well as the agreement on debt rescheduling reached in Berlin. The figures in the medium-term scenario would have to be looked at again, as they were based on certain assumptions on copper, oil, and coffee export prices. Those assumptions had changed; copper export prices were much higher in the world markets than had been assumed by the staff, while coffee and oil prices had declined.

The case of Zaïre had been given particularly close attention at a recent meeting in Paris on the World Bank's special program of action for debt-distressed countries, the staff representative from the African Department noted. The World Bank staff had indicated that the financing gap in Zaïre was larger than the gap shown in the Fund staff report. The donors at the Paris meeting were fully aware of Zaïre's external financing need, but financing pledges were not sought at the meeting, and it was uncertain whether or not the gaps could be filled, even if rescheduling on exceptional terms could be arranged. For example, the ratio of debt servicing to government receipts would be 45 percent in 1988, assuming debt rescheduling on the same terms as in 1987. The government's revenue base had become increasingly inelastic; the ratio of receipts to GDP had been as high as 18 percent in 1985, but had declined sharply to 13 percent in 1987 and was projected to decline further in 1988.

The Deputy Director of the Exchange and Trade Relations Department said that the staff was hesitant to recommend a partial payment scheme for Zaïre. The staff continued to take the view that arrears should be cleared in full, given that the emergence of arrears was recent, and that Zaïre would have been able to meet its external obligations in 1988 if a program had been in place.

Mr. Mawakani commented that he did not agree with Mr. Rieffel that Zaïre had decided to accumulate arrears not because it was unable to pay, but to show its dissatisfaction with the policies that the Fund had recommended. Zaïre was committed to paying its obligations to the extent possible. Zaïre's arrears were the result of its difficult financial situation and not a refusal to pay; before the payment on October 11, Zaïre had already paid SDR 160 million to the Fund. Zaïre would make every effort, in consultation with the Fund, to clear the remaining arrears. In that connection, Zaïre had reduced its spending on imports of goods and services--the estimated import volume in 1988 would be 91.7 percent of that of 1987--which showed that Zaïre was making efforts to clear its arrears. It had not increased imports in order to stimulate growth; in fact, the economic growth target of 3 percent would not be achieved.

The staff should avoid linking its next mission to Zaïre to further repayments, Mr. Mawakani remarked. If the staff was asked by Zaïre to send a mission to discuss measures that could be adopted to improve the country's current situation, the staff should respond to that request, and not refuse to do so until all the arrears to the Fund had been eliminated. Finally, he did not know when exactly Zaïre would make its next payment, but his authorities were committed to clearing the arrears to the Fund as soon as possible.

The Acting Chairman made the following summing up:

Directors generally agreed with the thrust of the staff appraisal. While recognizing the important adjustment policies undertaken by Zaïre since 1983 and noting Zaïre's difficult external environment, Directors were of the view that the authorities' failure to implement fully appropriate adjustment and reform measures explained much of the country's present difficult economic and financial situation. In particular, Directors emphasized that the lack of persistent and sustained implementation of adjustment policies in the past was at the root of Zaïre's problems today. Despite a significant increase in the net transfer of external resources to Zaïre, policy performance was inadequate, the country's growth performance had weakened, and inflation had accelerated markedly.

Directors expressed concern over the slippage in budgetary performance in 1987 and developments thus far in 1988. They highlighted the need for firm and clear understandings regarding the required fiscal strategy in the medium term. To reverse the declining trend of revenue to GDP, Directors urged the

authorities to implement rigorously the recent measure converting specific taxes to an ad valorem tax, to eliminate the widespread exemptions from import duties, and in general, to strengthen tax administration. Directors also underscored the need for effective expenditure programming and controls, particularly in light of the large spending overruns in 1987, and for major and sustained actions to strengthen the public enterprises sector. A substantial strengthening of fiscal policy was required to reduce government recourse to the banking system and inflationary pressures in the economy, to prevent a further rise in the heavy burden of public debt servicing, as well as to avoid a crowding out of the private sector. In addition, Directors observed that interest rates were highly negative in real terms and urged the authorities to establish positive real interest rates quickly.

Directors regretted the slow pace of implementation of the structural policy measures outlined in Zaïre's first policy framework paper. Directors noted the widening of the spread between the official and parallel market exchange rates, and stressed that the exchange rate should fully reflect market forces in order to ensure an optimal use of resources. Directors also recommended the adoption of an appropriate petroleum pricing policy as soon as possible.

Directors believed that Zaïre was at a critical juncture. Rapid inflation has led to increasingly serious price distortions, and, despite substantially higher copper revenue, the balance of payments position remains precarious and external arrears are mounting rapidly. In the circumstances, Directors stated that it was imperative for Zaïre to adopt a strong and comprehensive adjustment program focused on reviving the economy and placing the balance of payments on a sound footing.

As regards Zaïre's overdue financial obligations to the Fund, Directors welcomed the recent partial payment, but regretted that Zaïre is not current. Given the urgency of the situation, Directors expressed the hope that the discussions with the forthcoming mission would be productive and lead to an early and complete resolution of this matter.

In sum, Directors emphasized that it was essential that the Zaïrian authorities re-establish Zaïre's creditworthiness. This requires in the first place that they promptly become and remain current in their obligations with the Fund, and accord the highest priority to these obligations. Second, it requires that Zaïre re-establish its earlier track record of adjustment with a focus on an agreed medium-term fiscal strategy and structural policies that promote private sector investment, production, and exports. The firm pursuit of growth-oriented adjustment and the avoidance of past stop-go practices are the surest way to unlock

the needed flows of development assistance from bilateral and multilateral sources that Zaïre continues to require to restore balance of payments viability in the medium term.

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

Mr. Rieffel commented that the assumption of his authorities regarding Zaïre's arrears was the same as that of the staff: the arrears would be eliminated immediately, and all future payment obligations would be made on schedule. He had meant to encourage the Government of Zaïre to move more rapidly to make prompt and full payment than other countries had done at a similar stage in the development of their arrears problem. He wondered how the staff would suggest dealing with cases in which the assumption that a member would pay its arrears in full was proving to be incorrect.

The staff representative from the African Department said that, in the light of the Interim Committee's discussion in Berlin on the report of the Executive Directors on overdue financial obligations, as well as the discussions with the Zaïrian authorities, the task of the staff was to start quickly policy discussions with the authorities to agree on a program for the second annual arrangement under the structural adjustment facility. The staff should also assess the authorities' willingness and ability to pay the Fund.

The Acting Chairman remarked that the effort that had been made at the 1988 Annual Meetings toward clearing Zaïre's arrears problem was a major step. The latest payment had not eliminated Zaïre's arrears, but it was a step in the right direction, and the effort to clear the arrears would continue. The communication from management to the authorities summing up the discussion could stress the urgent need to clear the arrears, which several Directors had mentioned.

Mr. Enoch recalled that he had suggested a redraft of paragraph 4 of the decision--to make it identical to the text for Honduras--which meant that the next review would be held in two months instead of three months. It would be helpful to conduct the review in December 1988, so that the latest development in Zaïre's case could be taken into account during the review of charges and the rate of remuneration for the first quarter of 1989. The Interim Committee had agreed on a more robust strategy for seeking early solutions to arrears problems, and the case of Zaïre was the first possible occasion on which to apply that strategy, since the discussions in Berlin.

Mr. Mawakani commented that the case of Honduras was not comparable to the case of Zaïre. He did not agree that Zaïre should receive different treatment only because it was the first case of a country in arrears to the Fund to be discussed in the Board since the Annual Meetings

in Berlin--especially as Zaïre had just made a substantial payment to the Fund. It was necessary to give Zaïre some time to settle its arrears; two months might not be enough.

Mr. Rieffel noted that over the past six months or so there had been a gradual tightening of the treatment of arrears cases. Mentioning the agreement of the Interim Committee in the communication to the Government of Zaïre would nevertheless help explain why the Fund was taking that course of action. In any event, it would be preferable to have the next review in two months, instead of three months, because the subsequent review might well then fall between two missions, instead of possibly in the middle of a mission.

The staff representative from the Treasurer's Department explained that the latest decision on Honduras had been taken at the time of the second review of its arrears and not at the stage in which Zaïre was at present. Applying that kind of decision now would go beyond what had typically been done at a comparable stage of other arrears cases, but would not be without precedent. There had been a similar approach in the case of Peru; the decision on Peru had included the expectation that Peru would be declared ineligible at a subsequent review, and that decision had been taken in the light of the circumstances of Peru.

Mr. Massé said that he agreed with Mr. Mawakani's argument that Zaïre might need three months to put in order its finance relations with the Fund. Given the possible accumulation of arrears over the next few months and the authorities' goodwill in making the recent partial payment, it would be counterproductive for the Fund to take tougher actions at the present stage. The case of Peru was not comparable to that of Zaïre, as Peru had not indicated the same kind of commitment and goodwill as Zaïre, and Peru appeared to have sufficient reserves to pay the Fund quickly. The main objective of the proposed decision should be to encourage the Zaïrian authorities to restore normal relations with the Fund. Therefore, it seemed best to leave the text as drafted.

Mr. Dai, Mr. Hubloue, and Mr. Serre said that they agreed with Mr. Massé.

Mr. Adachi remarked that he, too, agreed with Mr. Massé. The staff should provide an oral report on the results of the forthcoming discussions between the staff and the authorities.

The Acting Chairman said that in two months, prior to the discussion of the six-monthly review of overdue financial obligations in December 1988, the staff would give an informal presentation to the Board on the results of the mission to Zaïre. That kind of informal briefing, which had been made on previous occasions, would bring Directors up to date on the status of Zaïre's case. Ideally, by that time, the arrears would be cleared and the Board could have in mind a potential arrangement with Zaïre that would catalyze other sources of finance. Under that approach, the proposed decisions on Zaïre's arrears could be approved as drafted.

The Executive Board then took the following decisions:

Zaire - 1988 Consultation

1. The Fund takes this decision relating to Zaire's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1988 Article XIV consultation with Zaire, in the light of the 1988 Article IV consultation with Zaire conducted under Decision No. 5392-(77/63) adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Zaire maintains the restrictions described in SM/88/220 in accordance with Article XIV except for the restrictions on payments and transfers for current international transactions evidenced by external payments arrears, which are subject to approval under Article VIII, Section 2(a), and one multiple currency practice subject to approval under Article VIII, Section 3. The Fund urges the authorities to eliminate the exchange restrictions subject to Article VIII as soon as possible.

Decision No. 8995-(88/153), adopted
October 12, 1988

Zaire - Overdue Financial Obligations - Report and Complaint Under Rule K-1 and Notice of Failure to Settle Trust Fund Obligations

1. On September 2, 1988, the Managing Director submitted a report and complaint to the Executive Board (EBS/88/189), under Rule K-1 of the Fund's Rules and Regulations, setting out the facts on the basis of which it appeared to him at that time that Zaire was not fulfilling its obligations under the Articles of Agreement relating to repurchases and the payment of charges and interest in the General Department. In addition, the Managing Director issued a notice of the facts on the basis of which it appeared to him that as of September 2, 1988, Zaire was not fulfilling its obligations under Decision No. 5069-(76/72) with regard to the Trust Fund to repay disbursements and to pay interest under its Trust Fund loans, and pursuant to Decision No. 8165-(85/189) G/TR to pay special charges that are overdue to the Trust Fund. These facts and the complaint under Rule K-1 and notice of failure to settle Trust Fund obligations were communicated to the authorities of Zaire on September 9, 1988.

2. Having considered the report of the Managing Director, the complaint under Rule K-1 and notice of failure to settle Trust Fund obligations, and the views of Zaire, the Fund finds that Zaire has failed to fulfill its obligations under the Articles of Agreement as stated in paragraph 1 above.

3. The Fund regrets the nonobservance by Zaïre of its financial obligations, urges Zaïre to give these obligations the highest priority and to resume their observance forthwith, and decides: (a) pursuant to Rule K-2 of the Fund's Rules and Regulations that Zaïre shall not make use of the general resources of the Fund until such time as Zaïre has become current in its obligations under the Articles of Agreement relating to repurchases and the payment of charges and interest in the General Department, and (b) if Zaïre were otherwise eligible to make use of the general resources of the Fund, to take account of the existence of any overdue obligation to the Trust Fund in considering any request by Zaïre for the use of the general resources.

4. The Fund shall review this decision within a period of three months from the date of the decision.

Decision No. 8996-(88/153) G/TR, adopted
October 12, 1988

Zaïre - Overdue Financial Obligations - Report and Complaint Under
Rule S-1

1. The complaint of the Acting Managing Director dated October 7, 1988 regarding Zaïre's overdue obligation in the SDR Department, in EBS/88/195 (10/7/88), is noted. It shall be placed on the agenda of the Executive Board on the same date as the review of Decision No. 8996-(88/153) G/TR, adopted October 12, 1988. If at that time Zaïre is not current in its obligation to pay charges in the SDR Department, the Fund will consider suspending the right of Zaïre to use SDRs it acquires after the suspension pursuant to Article XXIII, Section 2(b), other than for settlement of financial obligations to the Fund.

2. The Fund urges Zaïre to give settlement of its arrears to the Fund the highest priority and to become current in its financial obligations to the Fund promptly, avoiding thereby the need for the Fund to take remedial action.

3. Consideration of the complaint in accordance with Rule S-1 particularly affects Zaïre. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative at the meeting at which the complaint is considered and at such subsequent meetings as the Executive Board may hold on the subject matter of the complaint.

Decision No. 8997-(88/153) S, adopted
October 12, 1988

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/88/152 (10/12/88) and EBM/88/153 (10/12/88).

2. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to Executive Director as set forth in EBAP/88/243 (10/7/88).

Adopted October 12, 1988

APPROVED: April 7, 1989

JOSEPH W. LANG, JR.
Acting Secretary