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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/162

10:00 a.m., September 24, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	Mawakani Samba
C. H. Dallara	M. K. Bush
	H. G. Schneider
	M. B. Chatah, Temporary
	M. Sugita
	B. Goos
Huang F.	
	Z. b. Ismail, Temporary
	J. R. N. Almeida, Temporary
	M. Foot
	O. Isleifsson, Temporary
	L. Leonard
	A. Abdallah
	W. K. Parmena, Temporary
	C. A. Salinas, Temporary
	L. P. Ebrill, Temporary
	J. de la Herrân, Temporary
	S. de Forges
J. J. Polak	
C. R. Rye	
	A. A. Agah, Temporary
	A. Vasudevan, Temporary
S. Zecchini	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

IBRD: D. A. Cook, Eastern and Southern Africa Regional Office. African Department: A. D. Ouattara, Director; L. M. Goreux, Deputy Director; E. L. Bornemann, A. Bourhane, S. E. Cronquist, M. G. Gilman, A. Jbili, M. G. Kuhn, G. B. Taplin. Asian Department: R. J. Niebuhr. European Department: P. B. de Fontenay, Deputy Director; B. Rose, Deputy Director; E. O. C. Brehmer, M. T. Hadjimichael, R. B. Hicks, H. B. Junz, J. Khallouf, M. Z. Khan, C. Liuksila, G. A. Mackenzie, T. H. Mayer, K.-W. Riechel, J. Somogyi, T. M. Ter-Minassian. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; S. J. Anjaria, J. T. Boorman, E. H. Brau, B. Christensen, S. Kanesa-Thasan, J. M. T. Paljarvi. External Relations Department: D. M. Cheney. Fiscal Affairs Department: A. A. Tait, Deputy Director. Legal Department: F. P. Gianviti, Director; A. O. Liuksila, R. H. Munzberg, J. M. Ogoola. Middle Eastern Department: G. Tomasson. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director. Treasurer's Department: D. Williams, Deputy Treasurer, D. Berthet, D. Gupta. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; E. Hernández-Catá. Office in Geneva: C. E. Sansón, Director. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: G. D. Hodgson, K. Murakami, J.-C. Obame, N. Toé. Assistants to Executive Directors: A. Bertuch-Samuels, W. N. Engert, L. Hubloue, A. R. Ismael, M. Lundsager, L. de Montpellier, T. Morita, J. K. Orleans-Lindsay, V. Rousset, L. Tornetta, H. van der Burg, B. D. White.

1. GATT MINISTERIAL MEETING - REPORT BY STAFF

The Director of the Exchange and Trade Relations Department made the following statement on the GATT Ministerial Meeting of September 24, 1986:

> Ministers representing the 92 CONTRACTING PARTIES to the GATT met in Punta del Este, Uruguay, last week and adopted a Ministerial Declaration that launches the Uruguay Round of multilateral trade negotiations. The negotiations will be carried out by a Trade Negotiations Committee that is to be convened before the end of October of this year. The Ministerial Declaration states that the trade negotiations will be concluded within four years.
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> On September 16, I delivered a statement to the Ministerial session on behalf of the Managing Director; I believe this statement has been circulated to Executive Directors. The President of the World Bank also delivered a statement the next day, stressing the importance that the World Bank attaches to the maintenance of an open trading environment.
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> As we shall be preparing a fuller report on last week's meetings for the information of Executive Directors, I propose at present only to highlight its main aspects. The Ministerial Declaration was adopted by consensus and represents a significant compromise on the main points of controversy. Against the background of recent trade frictions and strong protectionist pressures in many countries, the significance of this decision should not be underrated. Indeed, we believe that, compared with the Tokyo Declaration that launched the last round of trade negotiations in 1973, the Uruguay Ministerial Declaration is both more ambitious in its targets and more comprehensive in its scope.
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> The two main issues on which agreement proved most difficult were agriculture and services. For well-known reasons, the liberal trade principles of the GATT have not been applied as strongly to agriculture as to manufactured products, and the issue of how to redress this imbalance has been at the heart of many recent trade conflicts. The compromise that emerged after intensive informal consultations is intended both to satisfy those industrial countries--particularly the European Communities--that felt that the special socioeconomic characteristics of agriculture set limits on the extent of liberalization that is feasible in this sector, and other countries, including traditional agricultural exporters, which considered that farm support programs, and particularly export subsidies that may displace them from third country markets, should be reduced in accordance with the predetermined phase-out period. In the Ministerial Declaration, the CONTRACTING PARTIES agree that there is an urgent need to bring more discipline and predictability to

world agricultural trade. The negotiations are aimed at achieving greater liberalization of trade in agriculture and bringing all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines. The question of whether the negotiations should focus primarily on export subsidies in agriculture or whether they should encompass other types of domestic support policies and subsidies was also debated. In the event, the Ministers opted for a broad formulation. The Declaration calls for "improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes." A special negotiating group within the GATT will be primarily responsible for all aspects of the negotiations on agriculture.

In the area of services, as you know there has been an ongoing discussion among governments on the possible scope and modalities of negotiations on services. The GATT has had no previous direct experience with liberalization of trade in services; accordingly, it is not surprising that the question of broadening the scope of the next round to cover services proved so difficult. The Ministerial Declaration represents a compromise between those governments that wished to see the negotiations on services as an integral part of the GATT negotiations from the outset and those that wished to concentrate only on liberalization of merchandise trade before embarking on an international effort in the area of services in the GATT or elsewhere.

The relative priority to be accorded to the new services issue was also an important question before Ministers. The final resolution of this question is a pragmatic compromise. Thus, to accommodate both sides, the Ministerial Declaration is formulated in two parts. Part I deals with negotiations on trade in goods and was formally adopted at Punta del Este as a decision of the GATT CONTRACTING PARTIES. Part II deals with negotiations on trade in services and was adopted by consensus by the governments represented at the Ministerial session. Under Part II of the Declaration, Ministers decided to launch negotiations on a multilateral framework of principles and rules for trade in services. Specific disciplines may be elaborated for individual service sectors. At the suggestion of the developing countries, the Declaration states that the multilateral framework of principles and rules "shall respect the policy objectives of national laws and regulations applying to services and shall take into account the work of relevant international organizations."

In addition to agriculture and services, the Declaration lists a large number of areas that will be included among the subjects for negotiation. Part I of the Declaration covers a vast range of trade barriers and policies, including tariffs, nontariff barriers, tropical products, natural resource-based products, textiles and clothing, safeguards, subsidies and countervailing measures, dispute settlement, intellectual property rights, and trade-related investment measures. The principle of special and differential treatment for developing countries is reiterated in the Declaration.

From the earliest stages of the discussions, governments have been convinced that in the absence of a firm and explicit pledge to avoid further slippage into protectionism, agreement on the subject matter of the new negotiations alone will not suffice to deal with current protectionist pressures. Thus, the Uruguayan Ministerial Declaration includes a standstill and rollback commitment under which each participant in the negotiations agrees not to take any trade restrictive or distorting measures inconsistent with the GATT until the formal completion of the negotiations. In addition, while legitimately exercising their GATT rights, governments agree not to take restrictive or distorting measures that go beyond what is necessary to remedy a specific trade problem. Governments also agreed to roll back trade restrictions or trade distortions inconsistent with the GATT within the four years foreseen for the formal completion of the negotiations. To ensure compliance with the standstill and rollback commitments, the Trade Negotiations Committee will establish a specific surveillance mechanism.

Finally, I should note that, during the course of the discussions, a number of governments noted with concern the somewhat uncertain world economic situation we still face. References were made during the meetings to the problem of exchange rate volatility and to the links between trade and finance. In particular, a number of governments represented at Punta del Este stressed that it is neither logical nor feasible to expect the developing countries--and in particular the debtor countries--to continue to service their debt while maintaining or improving their economic growth rates unless they are offered access to markets. Although some earlier proposals to ask the GATT to conduct a study of the effects of exchange rate volatility on trade were not taken up in the final Ministerial Declaration, I would say that there was general recognition of the need for closer collaboration between the trade and financial institutions. A number of speakers called for increased cooperation between the GATT, the Fund, and the World Bank. In both the President of the World Bank's statement and our remarks, we offered our full cooperation with the GATT. In describing the objectives of the Uruguay Round of negotiations, the Ministerial Declaration calls for increasing the responsiveness of the GATT system to the evolving international economic environment and for enhancing the relationship of the GATT with relevant international organizations.

It is evident that, despite the notable advance made at last week's meeting, the upcoming negotiations will be difficult and a sustained effort will be needed on the part of governments to ensure that the objectives are achieved. Following the adoption of the Declaration by consensus, several governments made important statements and comments, particularly in the areas of agriculture, services, and the balance of benefits among contracting parties, which showed that the real negotiation effort still lies ahead.

2. GROUP OF TEN - DEPUTIES MEETING - REPORT BY STAFF

The Director of the Research Department, reporting on the G-10 Deputies Meeting in Paris on September 17, said that the following broad issues had been discussed--the world economic outlook and related policy issues, indicators, multilateral surveillance, and Fund policies. On the world economic outlook, the statements had not been different essentially from those that have been made at the Board Meeting by the Executive Directors of the G-10 countries. However, a note of uncertainty had been recorded. For example, mention had been made of uncertainty as to whether growth rates and exchange rates would move in a way to reduce international imbalances, as to whether exchange rates would be unduly volatile, and as to whether protection or protectionism would increase substantially. Nevertheless, the policy positions that have been represented in the Board by Executive Directors of G-10 countries had been restated generally in the G-10 meeting.

Several speakers had recorded the feeling that a number of a newly industrialized countries should make a greater contribution to the international adjustment effort than was currently the case, the Director continued. There had been strong support for the current debt strategy. On indicators and surveillance, there had been a general appreciation of the efforts of the Fund. Note had been taken especially of the chapter in the world economic outlook on the coordination of policies. A generally approving tone had been struck with the idea of focusing discussion on the sustainability of payments positions, referring to implications for domestic savings and investment relationships. Some speakers had felt that more follow-up to surveillance than was currently practiced was needed, but general support for ideas to establish specific norms for fiscal and monetary policy had not emerged.

There had been a general view that the Group of Ten had a special role to play in surveillance, and the Deputies had made some efforts to define that role, the Director went on. However, no clear consensus had emerged on the definition of that special role.

On the question of Fund policies, attention had centered on access policy, the Director of the Research Department stated. However, the position that had been taken by the Executive Board had been supported, and the discussion of the matter was not substantial.

3. ZAIRE - STAND-BY ARRANGEMENT - WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA

The Executive Directors considered a staff paper on Zaïre's request for a waiver and modification of performance criteria under the 22-month stand-by arrangement for Zaïre that became effective on May 28, 1986 (EBS/86/221, 9/19/86).

Mr. Mawakani made the following statement:

> The special consultation discussion on Zaïre, about four weeks ago, provided the Board with the opportunity to be briefed on recent financial developments and the special circumstances that led to them. As Directors will recall, this chair also stressed the full committment of the Zaïrian authorities to pursue their adjustment efforts in order to attain the objectives of the current stand-by arrangement. The difficult circumstances under which these efforts are being made cannot be overstated. And as clearly indicated in the staff report on the authorities' request for a waiver and modification under the stand-by arrangement, the prompt implementation of the strong corrective measures have succeeded in putting the adjustment program back on track.
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> In its assessment of recent developments and prospects, the staff has pointed out that despite the achievements of recent policy implementation, the authorities would have to face and deal with immediate and medium-term issues that could ensure the attainment of the program's objectives. Since the Board will have the opportunity to discuss these matters in detail at the conclusion of the first review, I will be brief. I wish to draw the attention of the Board to the following issue, which is crucial for consolidating the progress made thus far for setting Zaïre's economy on a sustainable path of growth. The issue concerns the need to lessen the vulnerability of the economy to exogenous factors and to ensure adequate external financial flows. In contrast with the substantial adjustments that the authorities are undertaking in the fiscal area, the external financial situation continues to be sensitive to developments in the prices of Zaïre's major exports and the availability of external financial flows. As stated by the staff, the balance of payments prospects for 1986 and 1987 would be difficult, unless Zaïre's terms of trade improve significantly. In addition, substantial financial assistance will be needed in order to support the endeavors of the authorities to continue to keep the program on course. It is their hope that on the basis of

the country's satisfactory debt servicing record under earlier rescheduling agreements, its creditors will again consider and provide adequate support for the country's adjustment efforts.

To conclude, I would urge the Executive Board to approve the proposed decision.

Mr. Schneider welcomed the fact that Zaïre's program under the stand-by arrangement with the Fund had been put back on track. The tables in the staff paper illustrated even more sharply than the information available at the previous meeting that Zaïre's adjustment process has been lengthened by an unprecedented export shortfall. Only close cooperation with the Fund, supported by continuous financial assistance, could help Zaïre to overcome its present difficulties. Most of the shortfall in 1986 would be offset by a drastic cutback of imports. Although that measure was undesirable in view of the impact on Zaïre's growth and medium-term adjustment prospects, it must be recognized that when countries with relatively strong records of adjustment, like Zaïre, experienced a strong deterioration of their external assistance, it was difficult to improvise productive measures quickly. For that reason, heavy pressure had inevitably been put on the program, and it was no surprise that the initial correction of the current account had come only from import reduction.

On the basis of the staff's preliminary discussions from its most recent visit to Kinshasa, he was confident that the Zaïrian authorities were firmly committed to the continued pursuit of their adjustment efforts over the medium term, Mr. Schneider continued. To that end, the authorities intended to accelerate in close collaboration with the World Bank, the implementation of measures aimed at broadening the sources of generating domestic revenue and improving the efficiency of fiscal and monetary administration. Therefore, he had no difficulty in supporting the request for a qualified waiver for the end-June performance criteria and for a modification for end-September criteria.

Another reassuring development was that despite some delay in adoption, both of the new World Bank loans for 1986 would be disbursed on an accelerated basis during the remainder of the year, allowing the resources to aid their original targets, Mr. Schneider went on. The disbursements would not only make a necessary contribution to financing Zaïre's balance of payments gap but also be of critical importance in preserving a minimal level of domestic growth and production under the present external conditions. A next step might perhaps be to increase levels of those loans and combine them with other sources of external financing in order to assure a more satisfactory level of domestic growth over the medium term. Along with the exceptional rescheduling from the Paris Club, which appeared necessary in view of the large financing gap expected in 1987, such an action on the part of the World Bank would help channel funds to growth-oriented activities.

For the immediate future, however, it was essential to quickly find a solution for financing the balance of payments gap remaining after the additional Fund disbursement expected in late 1986, Mr. Schneider remarked in closing. In view of the additional adjustment measures implemented by the authorities and the Fund's efforts to put the program back on track, his Belgian authorities were fully prepared to enter into a constructive discussion with the staff on how they could participate in the additional efforts required of Zaïre's donor countries. His authorities felt that such a discussion might usefully begin during the annual meetings and be pursued on a bilateral basis thereafter.

Mr. Dallara made the following statement:

> Recently the Board reviewed the report of the special consultation mission that had traveled to Zaïre to evaluate the effects of unanticipated wage increases in April and May. During the Board's discussion of that report, we expressed our serious disappointment that the increases had been granted without prior consultation with the Fund and, furthermore, that the action made it quite likely that the next set of performance criteria would not be met. Table 2 on page 3 of the staff paper clearly demonstrates that the large jump in the wage bill has led to wage costs which are now more than 40 percent higher than the amount originally programmed. The information presented to us in these tables also indicates that the wage increases were announced and implemented at a rather inopportune time, in light of the adverse effects on tax revenues which were in process as a result of the drop in export prices. Of course, we now know as well that the June targets were not met. In this connection, we were a bit surprised that in spite of the attention that had been given to this issue in the documents that had been reviewed in August, the wage actions and their effects on the overall program were not treated more clearly, and in more detail, in the documents. Only a brief mention is made of them on page 2 of the report.
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> We have noted, however, that beginning in July, the authorities have implemented a number of compensating measures, and the staff report states clearly that these are "strong corrective measures" and that, "the adjustment process is now well under way."
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> We commend the authorities for these actions, which, in our view, were essential in light of the earlier wage measures and the export developments, which of course have had their revenue effects. Unfortunately, the additional measures--both on the revenue and expenditure side--have not contained the overall deterioration in the program resulting from both the wage increases and the export developments, where I believe we have a deterioration in the overall deficit of some 1 percent of GDP from the original program. It clearly will be difficult to secure full budgetary financing to cover this gap, and this may

mean that even stronger efforts on expenditure control may be required in the immediate period ahead in order to help assure attainment of the program objectives. Additional concessional assistance obviously would facilitate the resolution of this issue.

We find this to be a rather complicated case. As we had been earlier informed, Zaïre did meet end-April performance criteria; but in light of the sizable wage increases and the resulting deviation from end-June ceilings--and the questions relating to the external accounts, as well as overall performance--it had been appropriate to wait for a further Fund disbursement until program performance could be more fully evaluated. We are now informed that important compensating measures have been adopted by the authorities, which go some way toward restoring our confidence in their commitment to the adjustment effort. I would like to assure the Zaïrian authorities that these efforts in recent months have not gone unnoticed by my authorities.

Nevertheless, we find ourselves in a circumstance where although we are advised that performance is heading in the right direction we have little data to give us assurances that, indeed, it is consistent with overall program targets; and in a number of respects we would have considered it preferable to wait until the end-September performance was before us and could be verified before providing for further drawings from the Fund.

Nevertheless, in light of the efforts that have been made by the authorities, we are prepared to put aside our reservations on this issue at this time, and--on the information that has been provided to us and in light of my authorities' desire to support Zaïre's efforts--to deal with their serious problems. On this particular issue alone, we are prepared to support the request before us today.

Furthermore, I should say that if end-September performance is consistent with all of the targets and the review is completed consistent with the program objectives and commitments, we would be prepared to support a further drawing in November under this program. Of course, multiple drawings at that time would not be appropriate in light of the drawing allowed by the Board today.

There is another aspect of this program, however, which is of concern to us, and that is the financing of it. It is rather unusual, if not unprecedented, that we have a clear statement in the documents before us that there is a financing gap of SDR 81 million for this year; not to mention the huge financing gap for 1987, a substantial portion of which, I understand, could be taken care of through rescheduling in 1986 if this were done by the various creditors involved. But for the Board to approve a drawing at this time, in light of this SDR 81 million financing gap, does raise some questions in the minds of my authorities as to whether or not continued progress under this program is attainable--even if the Zaïrians make every effort that they possibly can in the months ahead. And, indeed, we do wonder if we are in good faith supporting Zaïre's efforts; if we support drawings, knowing full well that this gap exists, and knowing that the staff did not build in any great deal of excess comfort in this program at the outset. What does this really say about the practicality of achieving the objectives under the program?

It is unfair to ask the Zaïrians to make the efforts, which they are making, in the context of this serious external development; having serious doubts that, indeed, these efforts will produce results, because, if for no other reason, there may well be inadequate external financing.

Certainly, the possibility exists of reducing reserve targets under the program; but that would be a rather short-sighted approach. We are given in the footnote on page 5 of the staff paper an indication of the change in the level of net reserves since the end of 1985. Net reserves appear to be about SDR 20 million, a low level. It would seem to us not a very prudent thing for the Zaïrians, nor for the Fund, to encourage significant reductions--or reductions at all--in those reserve targets.

Regarding the Fund's role in filling the financing gap, I recognize that there are differences in the nature of financing and in the nature of assistance that comes to some Fund members in contrast to others. Some depend more heavily on commercial bank financing than others. But I wonder--not just in this case, but more generally, whether the staff, in particular from the Exchange and Trade Relations Department, could give me some indication as to whether or not there is a consistent Fund approach here. And, if not, whether or not we need to think a little more about this as a general policy matter. Because I find it difficult to understand, that in one case, we say the Fund financing is below the line and is not part of the financing gap effort and in other cases we seem to view it as part of a financing effort.

This leads me to the question of whether or not it might not have been desirable--or whether consideration might not have been given to some sort of an approval in principle today by the Board--in order to give a positive indication of the Board's willingness to support Zaïre, of the Fund's willingness to continue its support to Zaïre, and yet at the same time to signal to bilateral donors that without additional assistance this program is not likely to work.

One possible approach here would be an approval in principle with an opportunity taken, let's say in the next 12 or 14 days, for efforts among donors--many of whom, of course, will be represented at very senior levels at the Annual Meetings--to see what can be done to fill this mid-1986 problem; and perhaps prior to considering the 1987 problem. I would not insist that this be done before the Board approves this program, but I wonder if some consideration should not be given to it. In any case, I wonder whether we are taking an unprecedented decision, if we do not take this approach, by approving the program outright in the context of this financing gap. The concerns of my authorities are that we do everything we can to support Zaïre in the case of these extreme difficulties, and we wonder, indeed, if a Board decision in principle might be the most effective way of doing that at this time. But I would be interested in hearing the staff's comment on this.

Certainly, it would seem that those bilateral donors who have been most anxious to have the Fund step back in with financial assistance would be prepared to give every consideration to their own financial prospects, since they fully recognize the limited role of the Fund in this process. And I have welcomed in this connection, in particular, Mr. Schneider's comment this morning that his Belgian authorities stand ready to participate in an effort to provide financing in addition to that of the Fund.

Whether we ultimately go for outright approval or approval only in principle today, we do believe that a meeting--as Mr. Schneider suggests--in the days ahead, to make every effort to secure needed additional assistance for Zaïre, would be appropriate.

And I would like to conclude by reaffirming that my authorities do support Zaïre's adjustment efforts. It is in the context of our clear impression that--even though all the quantitative data may not be there- that, indeed, they are making serious efforts now, that we are prepared to endorse these waivers and support one disbursement at this time. At the same time, we hope that other forms of international assistance will be equally forthcoming, so that Zaïre's efforts will, in fact, be hopefully rewarded with some actual positive outcome in terms of balance of payments sustainability and growth.

Mr. Goos said that he supported the staff appraisal and the proposed decision. His support rested on the impression that in general the authorities remain committed to the objectives of the adjustment program, which was evidenced by the recent additional efforts that had been made to contain the divergence of the actual performance from the originally agreed adjustment path. While those measures should go a long way toward bringing the program back on track, he was concerned that much of the progress appeared to reflect exceptional features--such as special capital transfers, inclusion in the budget of a number of parafiscal agencies that were apparently the most profitable ones, and further compression of public investment that was probably unsustainable.

At the same time one had to note that current expenditures, other than those for arrears and interest payments, still substantially exceeded the original program target, Mr. Goos continued. Therefore, it appeared that much remained to be done in order to make the fiscal position viable and to further narrow domestic and external imbalances. He agreed with the staff that the pursuit of tight fiscal discipline was essential both with regard to the attainment of the end-September target and the forthcoming review, the successful completion of which would undoubtedly be crucial to the release of further funds and to the continuation of the Fund stand-by arrangement.

The need to maintain and strengthen adjustment was underscored by the financing gaps in 1986 and 1987, Mr. Goos went on. In that regard he shared a great deal of the concerns that had been expressed by Mr. Dallara. The expected gap for the current year raised difficult questions in the context of the proposed release of one further drawing, given the Fund's practice of supporting only programs that are fully financed. Unfortunately, he was not in a position to indicate to what extent, if any, his authorities might contribute to the closing of that year's gap. However, he would draw attention to the considerable financial contributions that had already been made by his authorities.

After listening to Mr. Schneider, he was confident that with the necessary adjustment efforts in place, the Zaïrian authorities would succeed in mobilizing the necessary funds, Mr. Goos remarked in closing. That development might include greater use of Zaïre's own external reserves, although that option was clearly limited. He had sympathy for Zaïre's difficult adjustment task that had been complicated by the unfavorable external environment. In that light, he commended the authorities for having remained current on Zaïre's external obligations.

Mr. Leonard made the following statement:

> During the Board's last discussion on Zaïre on August 25, this chair felt that a detailed examination of Zaïre's situation by the Fund staff was necessary in order to determine whether Zaïre could return to compliance with the stand-by arrangement. In the staff paper now before us we have a rather mixed assessment of recent developments. Since the stand-by arrangement was approved, external conditions have weakened, most notably in terms of prices for Zaïre's major export commodities. These less favorable external developments fed through to other areas of the economy, and the authorities were slow to adjust fiscal and monetary policies. In particular, it was disappointing that the end-June target for net credit to the Government was exceeded

by a considerable amount. As a result of the combination of weaker external conditions and the slow policy response, Zaïre is now confronted by an increase in the estimated balance of payments financing gap in 1986. In addition, a significantly larger financing gap is projected for 1987.

On the credit side, the authorities have taken strong corrective action since July, and the staff informs us that the adjustment process is now well under way. This is good as far as it goes, but Zaïre must also maintain a strong policy stance not only during the period of the stand-by arrangement but also within the medium term if it is to marshal the donor support it will need to finance its balance of payments position over the next several years.

I come now to the waiver and modification. While the excess in credit to government at end-June was substantial and the departure from the stand-by arrangement correspondingly disappointing, the efforts since July to strengthen the fiscal and monetary positions are impressive. In the light of these efforts, this chair regards as reasonable the modifications proposed by the staff and the waiver of the end-June performance criteria related to net credit to government. My initial position, therefore, was to support the proposed decision, while again impressing upon the authorities of Zaïre the need for a credible and medium-term approach to policy. However, Mr. Dallara's suggestion of approval in principle subject to agreement among donors on bridging the prospective financing gaps was worth further consideration, and I would like to hear other members' views on it before committing my chair.

Mr. Foot said that he joined other speakers in welcoming Zaïre's efforts to rehabilitate the program under the stand-by arrangement. The qualified waiver proposed by the staff was a fair compromise under the circumstances, and the proposed changes to the criteria for end-June and end-September, as set out on page 12 of the staff report, were sensible. He could go along with approving one drawing immediately.

However, it would seem prudent to wait for the first review before considering the authorities' request for further drawings, as well as any possible rephasing of drawings, Mr. Foot considered. Indeed, considering the unfilled financing gaps he acknowledged how it might be a case for approving the program only in principle. However, after hearing other Directors' comments and since the gap for 1986 was relatively small, his feeling was that the Board should approve the program outright. Despite the figures in the paper there seemed to be no cash for crisis in 1986 and future drawings on the remainder of the funds granted under the stand-by arrangement would depend on staying in compliance which would be closely watched. The Fund had gone forward in cases with far larger financing gaps--Jamaica in February of 1986 and Guinea recently and

Somalia. Perhaps the Board needed to establish a general principle out of one of the cases. But as far as Zaïre was concerned, 1987 would be the key year. Everything should be in place by the November review--the Zaïrian budget for 1987 and the Paris Club rescheduling--hence, the Board could face up to the issue of the 1987 gap at the November review.

In the short term, the problem was not as bad as it appeared, and the authorities could wait until November, although he would appreciate staff comment on that opinion, Mr. Foot continued. His authorities would consider the needed Paris Club rescheduling sympathetically. However, there were limitations within the Paris Club rules as to what could be done for members.

It was clear that the 1986 financial position would be tight, Mr. Foot went on. Nevertheless, that fact in itself was not a reason for giving undue preference to a member. The compromise suggested by the staff was perfectly adequate. In addition, while Zaïre's external circumstances had been more difficult than originally forecast, some of the problems had been induced by domestic policy changes; for example, excessive wage awards and intervention by the Bank of Zaïre to support the exchange rate during the first half of 1986.

It appeared that the staff was working as quickly as possible on an arrangement under the structural adjustment facility, Mr. Foot said in closing. One of the key inputs would be the 1987 budget, which would be ready in November. That budget provided one cornerstone of the timetable for the arrangement under the structural adjustment facility that could not be moved. The staff would bring up the issue as early as possible thereafter in light of the need to have a clearly viable program.

Mr. Abdallah made the following statement:

> There is no doubt that Zaïre is facing a very difficult period owing essentially to an unexpectedly sharp decline in export prices. The shortfall in export earnings in 1986, equivalent to SDR 273 million below export earnings, foreseen in the program under the stand-by arrangement, has set in motion a chain reaction leading to a sharp contraction in government revenue, a sharp reduction in imports, and, ultimately, a further slowdown in the rate of GDP growth in 1986. In the face of this deterioration, the authorities have taken remedial measures for which they deserve commendation. The additional revenue measures will offset a large proportion of the exogenously induced revenue shortfall so that the budgetary revenues will now fall short of the original program target by only Z 4.2 billion. At the same time, the authorities have trimmed down expenditures further so that in real terms they are expected to decline by as much as 15 percent. It is unfortunate that under the circumstances, investment expenditures have been restricted to counterpart funds arising from foreign finance. This clearly demonstrates that there is no room for further cutbacks in expenditure on the part of Zaïre.

Yet this leaves Zaïre with an additional financing gap in the budget of Z 3.0 billion, half of which the staff has indicated must be filled through external assistance if the program targets are not to be jeopardized. On the external sector, a financing gap of SDR 17 million remains in 1986, and the staff has indicated that in all likelihood the external sector will deteriorate much further in 1987, with the financing gap rising to about SDR 600 million assuming continuing Fund assistance. Before offering any comments on these widening gaps let me make one observation on the program itself.

To my mind, the program appears to be based on fairly shaky assumptions concerning world prices of Zaïre's exports and possible sources of filling the financing gaps, assumptions which have not materialized in the past and are now causing additional difficulties if the program has to be kept on track. In particular, I have noted that the staff foresaw the possibility of lower export earnings with the staff report indicating that shortfalls of SDR 171 million were foreseen. At present, export shortfalls are expected to be SDR 273 million. The question is, having foreseen the shortfall, what contingency mechanism did the staff make for it and/or what advice was given to the authorities about it at the time the program was originally launched? This is one case where a contingency mechanism similar to the one incorporated in the Mexican program would have been advisable. With regard to the financing of the shortfall, I would appreciate staff comments as to the extent to which the anticipated financing can reasonably be expected to be forthcoming in 1986--namely, lower imports, additional debt relief, and possible first disbursement of funds in an arrangement under the structural adjustment facility. Or, stated differently, to what extent are these financing sources going to contribute to filling the gap in 1986?

Turning back to the financing gaps for this year and next, I believe that the authorities should now focus more directly on additional debt rescheduling and the possibility of Fund drawings under the compensatory financing facility and an arrangement under the structural adjustment facility. With regard to the Fund resources, I would appreciate staff comments with respect to the levels of finance and the likely speed of disbursement given the urgent need for these resources by Zaïre.

In addition, I wish to stress that the adjustment effort under the stand-by arrangement program has cost Zaïre dearly in terms of GDP growth, which is now expected to fall below the 2 percent level realized in 1985. In view of this, the staff should ensure that the structural adjustment program, to be supported by resources deriving from an arrangement under the structural adjustment facility, restores the GDP rate of growth over the three program years to respectable levels. The staff and the authorities should also use an arrangement under the structural adjustment facility as a rallying point to catalyze additional resources from the World Bank, multilateral agencies, and bilateral sources.

Finally, I wish to support strongly the request for waiver and modification of the performance criteria. I notice that the staff is recommending a qualified waiver concerning nonobservance of the June performance criteria. The nonobservance of the net credit to the government in June was clearly related to the revenue shortfall induced by external factors beyond the authorities' control. In any case, the excess in net credit to the Government was shortly eliminated by exceptional transfers. As far as private sector credit is concerned, we note that it would have been broadly within the program target except for the reclassification of the Z 1.67 billion from foreign assets to domestic credit. Under these circumstances, what the authorities need is not penalties but sympathy and encouragement in their adjustment effort and for this reason I see no need for a qualified waiver that will have the effect of withholding SDR 23.8 million which is badly needed. I would, therefore, favor an unqualified waiver so that Zaïre can draw SDR 47.6 million.

I can also go along supporting the proposed modification of the performance criteria for September since the inclusion of end-June data would give a distorted picture while the raising of the target for domestic assets by Z 1.67 billion follows logically from the reclassification. Finally, I support the moderate increase in the limit to external short-term borrowing from SDR 50 million to SDR 60 million.

Mr. Rye made the following statement:

In the recent Board discussion on the special consultation with Zaïre, I expressed disquiet about the country's performance so far under the stand-by arrangement. The present staff report goes some way toward allaying those concerns; at least it confirms that some strong corrective measures have been taken to compensate for the large increase in government wages in June and the further deterioration in Zaïre's terms of trade. I note with approval the expenditure measures adopted, which should enable the original program estimates for government expenditure to be realized.

Having said that, it is now all the more evident that the June increase in government pay was a most regrettable action. The need to take corrective measures on this account left only a narrow margin for adjusting expenditures further in response to "possible" revenue shortfalls--which have of course turned out to be actual revenue shortfalls. It would seem that the staff sees the only remaining possibilities as higher domestic bank financing and additional donor assistance. While additional assistance is obviously needed, it is unfortunate that Zaïre has given itself less room to take additional measures in support of its requests for that additional assistance.

An even greater cause for conern is the very difficult outlook for 1987. The current account deficit and the external financing requirement are projected to be larger in 1987 than in 1986, the financing requirement increasing to nearly SDR 700 million--even after allowing for some improvement against the recent trend in the private capital account balance. Even with very generous debt relief it would seem that this gap will be very difficult to close--in which regard, official amortizations scheduled for 1987 amount to less than SDR 400 million. So even if this was all rescheduled to later years, there would be an additional new money requirement of more than SDR 300 million. Perhaps the staff will confirm that I have got these figures correct.

For now, though, on the understanding that the corrective measures taken since July have been sufficient to get the original program back on track, I am prepared to support the proposed decisions. This would provide Zaïre with a purchase equivalent to that which, but for the program going off track subsequently, Zaïre would have been able to make after meeting the end-April criteria. On this basis, the purchase contingent on the end-June criteria has--rightly in the circumstances, been suspended.

Whether the present program will be adequate to the task ahead is a matter that will need close attention in the upcoming review. I note with approval in that regard that while we are agreeable to modifying the September performance criteria at this point, the pruchase attached to the September test date will not become available until after the first review of the program. With respect to Mr. Dallara's comments, it seems to me that is the time when we also need to be assured that full financing of the program is in prospect and, of course, that the program itself is viable.

In the meantime, I can as I say support the proposed decision.

Mr. de Forges made the following statement:

At this stage of the discussion, I would like first to recall that we supported the staff's approach at the beginning of the summer, at the time when it was learned that there were difficulties stemming from unexpected Zaïrian decisions. Nevertheless, my authorities now consider, as we expressed on

August 25, that the needed special consultation did not have to have the effect of unnecessary delays in Fund support of the Zaïrian adjustment process. In this respect, we note that the staff report makes a very clear presentation of the strong corrective measures taken by the authorities to compensate for the sharp deterioration of Zaïre's external terms of trade. The measures, encompassing both the fiscal and external sectors, demonstrate the authorities' firm commitment to the adjustment process. Thanks to these corrective measures, it now appears that the 1986 financing gap estimated at SDR 81 million could be completely filled by the resources normally expected from the Fund under the original schedule. In these resources I include all the purchases previously anticipated under the current stand-by arrangement and a first disbursement under an arrangement under the structural adjustment facility.

In light of these two previous considerations and in spite of the very constructive attitude of the staff during the recent mission, my authorities feel that the decision that is proposed today is disappointing and represents only a second-best choice. Indeed, in my authorities' view, now that the Zaïrian authorities have corrected their policies, it would be awkward to adopt an unnecessarily penalizing attitude as this could discourage the authorities instead of encouraging them to pursue the readjustment engaged in July. Moreover, under the proposed qualified waiver, authorized purchases would be limited to one instead of two in the short term. Given the extremely low level of Zaïrian reserves, such a decision would make it very difficult for Zaïre to consistently meet all its external obligations. Furthermore, we were concerned to observe that the first disbursement under the arrangement under the structural adjustment facility was scheduled for 1987, thus depriving Zaïre of the possibility of drawing on this resource to fill the 1986 financial gap.

Therefore, my authorities have instructed me to request the adoption of a full waiver. At the same time, they attach high importance to the Fund and Zaïre making every effort to remain in a position to present the request for the first year arrangement under the structural adjustment facility before the end of the year.

In conclusion, I wish to indicate that my authorities, who are counted among the friends of Zaïre and who proved it through the considerable financial effort put forth during the last Consultative Group, are now scanning ways and means to answer the prospects for 1987. To that end they will fully participate in any meeting organized in the near future.

Mr. Zecchini made the following statement:

Developments in Zaïre in the first half of 1986 have been disappointing, as the negative consequences of a weakening in export prices on the balance of payments and on government finances have been compounded by inadequate financial and exchange rate policies. As pointed out in the staff report, the June performance criteria have been overshot by substantial margins following a widening in the fiscal deficit and a sharp increase in net credit of the Government. Furthermore, the real effective exchange rate was allowed to appreciate by 11 percent in the first half of 1986.

In order to compensate for these policy slippages and to respect the thrust of the program, a considerable strengthening in adjustment efforts is required in the secod half of the year. In this respect, we were encouraged to see that, and I quote from page 11 of the staff report, "in July the authorities took strong adjustment measures, and the adjustment process is now well under way both on the external and on the fiscal sides." The authorities' renewed efforts, the staff's confidence that these measures should bring the program back on track, and the time constraints imposed by Zaïre's difficult financial situation are all elements that make us appreciate the efforts to keep this program operative. However, in today's discussion we should not focus only on Zaïre's specific problems but also on its implications on the Fund's credibility and policies. In the latter respect, the proposed decisions make us feel rather uneasy as they may constitute an exception to the general approach that had been followed with good reason so far.

First, it should be noted that we are authorizing the disbursement of Fund resources without having enough evidence that the program is back on track since the June performance criteria have not been observed, and it is, of course, not yet possible to ascertain whether the end-September criteria will be met.

Second, uncertainties exist on the financing of the program as it is demonstrated by the emergence of a financing gap in the balance of payments for 1986, and an even larger one for 1987.

Third, with respect to access policies, we would like to have some clarifications from the staff whether the observance of the September performance criteria would allow for a disbursement of only one or of both the June and the September credit tranches. In this respect, we would appreciate if the staff could elaborate on the approach that has been used so far in cases of programs that have gone temporarily off track and for which a modification has been granted. More specifically, we would like to know if total access in these cases has been reduced or whether it has been maintained at the previously agreed levels.

In sum, we can reluctantly go along with the proposed decisions on the understanding that the authorities will adopt all the measures necessary to bring the program back on track. In this respect, we attach more importance to the basic overall thrust of government action to redress the economic situation than to the compliance with any individual target. Given the existing uncertainty surrounding the present adjustment effort, we expect that the authorities will take much stronger measures in the coming months, and only on this basis, will we be ready to consider the next program review favorably.

On the question of the approval in principle, we share the concern expressed by Mr. Dallara, and we agree with his considerations. However, we have another consideration to raise in this respect. Specifically, by allowing an approval in principle, are we going to introduce innovation into the contents of our program reviews? Should we, on each individual occasion, check the financing gap? We could be faced with a situation of having to approve program reviews in principle on a continuous basis, and it is difficult at this time to see the advantages of such a development over the present approach. Therefore, we support the proposed decision for Zaïre, but at the same time we consider it appropriate to have a discussion on the general issue at a later stage.

Mr. Huang made the following statement:

Since the start of the current stand-by arrangement, Zaïre has suffered a sharp deterioration in its external position resulting from an unexpectedly sharp decline in prices of main exports. Simultaneously, external shocks led to a deterioration in the fiscal position resulting in Zaïre being unable to meet the performance criteria under its present stand-by arrangement and to make the second purchase for end-June 1986.

Despite external shocks owing to factors beyond Zaïre's control, the authorities have taken a number of strong adjustment measures to cope with the great imbalance in both its external and fiscal positions. However, it is evident that Zaïre's economic situation will remain very difficult through 1986 and in the years to come; and it is also evident that Zaïre will need exceptional large-scale financial assistance from the Fund and the donor countries to continue its adjustment efforts.

In light of these, I believe Zaïre has proved to be worthy of the Fund's financial assistance, and I fully support the proposed decision.

Mr. Polak remarked that he could support the gloomy outlook of the situation described by Mr. Rye and by Mr. Foot--namely, given the fact that the authorities had at present adopted a major adjustment effort that could not be further intensified, the correct action for the Board to take would be to adopt the technical action proposed by the staff and make that an outright decision, although not a decision in principle, and rely entirely on the review that was coming up within the year to appraise the question of the gap and how it was to be financed.

Mr. de la Herrân said that his chair supported the proposed decision. In light of the extremely difficult situation, the Fund should show a determination to back the authorities and the program. Approval of the decision would produce viability and financial support for the program.

The Deputy Director of the African Department stated that he would clarify two points that had been raised regarding the calculation of the gap both for 1986 and 1987. In the staff paper that had been circulated in April 1986 (EBS/86/76) for the original presentation of the program, the staff had included all the original scheduled purchases and had calculated the gap after taking scheduled Fund purchases into account. The present paper included two purchases that had been made from the Fund--the first for SDR 33 million, which has been made under the previous stand-by arrangement, and the one for which a waiver was being requested. However, the staff had not included any further purchases in 1986 partly because of not knowing whether it would be one purchase or two purchases in November; if one purchase was made in November, provided that the performance criteria as modified were observed, the gap would be reduced to SDR 67 million; and if two purchases were made, it would be reduced to SDR 33 million.

The staff had indicated that the reserves of the central bank were virtually depleted at the end of June, when the reduction from end-December 1985 to end-June 1986 had been SDR 48 million, the staff representative continued. Because of the special transfers made in July, the net reserves of the central bank had improved somewhat during that month, and the net reserves at end-August were estimated to be about SDR 27 million lower than they had been at the end of 1985, which meant that they were very low but that they were not as low as they had been at the end of June when they had been virtually depleted. The staff had kept the original target of an increase in reserves of SDR 28 million in calculating the gap because that original target of a modest buildup in reserves was necessary to permit the Bank of Zaïre to honor its external obligations in case of problems such as a sudden drop in export prices. This reserve target might, however, not be attained by the end of 1986.

Regarding the gap for 1987, the staff had not included any of the originally scheduled Fund purchases under the current stand-by arrangement, not knowing whether there would be some sort of rephasing of the purchases, the staff representative went on. The originally scheduled purchases from the Fund in 1987 amounted to SDR 95 million, and they had not been taken into account in calculating the gap for 1987.

Regarding the payments that were due, excluding payments to the Fund, the interest charges for 1987 were SDR 336 million and amortization of SDR 384 million, an amount that totaled SDR 720 million excluding the Fund, the staff representative remarked. The major part of that amount was due to the Paris Club. The remainder included some payment to multilateral institutions in the order of SDR 50 million and the payment to the London Club, for which the rescheduling of the amortization was about SDR 50 million. The major problem was to find a proper financing for the year 1987, given the unfavorable prospects for export earnings.

A staff mission would return to Zaïre in November in order to verify whether the performance criteria for end-September have been observed, to finalize the program for 1987--which could be supported under the existing stand-by arrangement--and to assess the possibility of finalizing an arrangement under the structural adjustment facility in cooperation with the World Bank, the staff representative noted. In the recent staff mission, discussion had only been started on a macroeconomic framework for the period 1987 through 1989. At the time of the second review of the program, about November 20, the mission would have returned from Kinshasa and might be able to outline a program for 1987, including proposals for performance criteria under the stand-by arrangement for 1987. However, an arrangement under the structural adjustment facility could not be concluded before the beginning of the 1987.

The proposal made by several Directors to have some preliminary discussion during the Annual Meeting regarding the problem of financing would obviously be followed up by the staff, as well as some bilateral discussion later on, the staff representative from the African Department stated. The issue of balance of payments viability should be reviewed in the context of the program under the stand-by arrangement for 1987 and an arrangement under the structural adjustment facility. A generous rescheduling would be required in 1987, but if the interest rate charged on the refinancing of the interest initially due substantially exceeded the rate of growth of export earnings, the balance of payments situation would remain very difficult.

The staff representative from the Exchange and Trade Relations Department said in response to a question asked by Mr. Zecchini that indeed there was a number of possibilities open to the Board in terms of rephasing when performance under a program had remained off track for some time. On occasion the amount of access had been reduced. Sometime the period of the stand-by arrangement had been extended. Among others, those possibilities would need to be considered when the question of the first review came up before the Board.

Regarding the financing gap, it was not unusual for programs to go beyond 12 months and have unfinanced gaps in the program for the latter part of it, the staff representative from the Exchange and Trade Relations Department stated. What was unusual in the case of Zaïre was that there was an unfinanced gap in the first part of the program.

Mr. Foot remarked that he wanted to make sure that he understood the figures. As he understood it, the 1986 financing gap was set at SDR 81 million. That figure included an assumption of an increase of SDR 28 million in reserves from end-1985 to end-1986. If that increase were taken out, an SDR 53 million gap would remain. Reserves at the end of August were SDR 27 million lower than even at the end of December 1985, and yet the situation had still been viable. Reserves could therefore be left unchanged between the end of August and the end of December 1986. However, he was uncomfortable about reducing the financing gap from SDR 53 million to SDR 26 million. Nevertheless, with a possible further drawing in November of SDR 23.6 million, the gap would be virtually closed. In addition, Zaïre had a number of trade-related commercial bank loans that had not been fully drawn. Therefore, he found it difficult to see that there was much of a problem. Whereas he agreed that even accepting the current level of reserves would be extremely unsatisfactory, he was simply trying to establish the fact that a financing gap such as Zaïre's did not prevent the Board from approving one drawing outright. There was at least one other case in which the Board would face problems as severe as Zaïre's, if not worse. Therefore, the matter had other applications as well as the present one.

The Chairman remarked that theoretically it would indeed be possible to gain the SDR 28 million plus SDR 27 million, which would reduce the gap of SDR 81 million to SDR 26 million--which was quite close to the SDR 23.6 million that could be drawn in November. Therefore, working the matter out that way would solve the problem, except that it would not leave a lot of margin for maneuver in reserves.

The Deputy Director of the African Department said that reserves would be in the neighborhood of SDR 21 million more than they had been at the end of June, where they were virtually exhausted. Zaïre would then have a very low reserve position at the end of 1986.

Ms. Bush commented that it appeared to her that without a drawing from the Fund, reserves would be virtually zero. In an adjustment program that was already difficult, to reduce the reserves to zero was not a wise thing to do. Indeed, the general issue of the financing gap remained because there was a need to have reserves. It was the reason Mr. Dallara had raised the question that morning of approval in principle only. The staff had not specifically addressed that possibility in their response. Potentially, there were other applications of an approval in principle for a review situation, although that approach had not been taken in the past. The problem was that the financing gap was at the beginning of the program rather than toward the end.

The staff representative from the Exchange and Trade Relations Department noted that the present case before the Board was an unusual one. Indeed, the procedures and principles that had been developed for an approval in principle applied to the initial approval of the program and not to an ad hoc modification such as the one before the Board at present. In fact, the Board was not even conducting a review of the program, strictly speaking. That review would take place later. The staff was simply presenting a proposal for an ad hoc modification and waiver. Therefore, the question of approving a modification and waiver in principle had not been addressed by the Executive Directors. There would not be anything to prevent the Directors from deciding to make a decision of approval in principle of the proposed decision.

In response to Mr. Foot's comments, the staff representative from the Exchange and Trade Relations Department continued, the reserve position would indeed remain extremely difficult. Unsatisfactory levels of reserves had to be taken into account in assessing whether a program was back on track and whether the financing gap could be filled.

The Chairman remarked that there was still some doubt on the question of the adequacy of the reserves. Was the reserve figure a net figure? Would it still be positive, if all the liabilities were deducted from the gross reserves of Zaïre? For instance, there were the liabilities to the Fund.

The Deputy Director of the African Department stated that the liabilities to the Fund were on the order of SDR 660 million. Therefore, a net calculation would result in roughly SDR 400 million negative.

Mr. Polak commented that the Fund did not have a consistent approach to the question of reserves. On some programs for Latin American countries, the staff had deducted what the Fund gave, on one hand, while it counted the liability to the Fund immediately as negative net reserves, on the other. The approach followed by the African Department was more correct. If one pushed the Western Hemisphere Department's approach to the limit the Fund would contribute nothing to the gap and only add to the country's gross reserves, which was not the Fund's function. The Fund gave balance of payments aid at present in the expectation that in future, when the country was in a better position, it would be repaid. There was no point in subtracting at the time one added.

The Chairman noted that it was useless to reduce tiny margins of SDR 27 million reserves while ignoring the enormous liabilities that would one day have to be confronted. Therefore, there was still an unfinanced program for 1986, and he would like the donors to understand that. The donors were to shortly have a meeting in Washington. They understood that there would be no arrangement under the structural adjustment facility in 1986. The fact was that there was still a financing gap, if not of SDR 81 million, then of SDR 57 million. Therefore, the Board had to answer the question of whether it should take a decision in principle, as Mr. Dallara had suggested, expecting that the reserve situation would be resolved in the coming week or so, or whether the Board should adopt an immediate approval with the understanding that in the donors' meeting, serious attention would be drawn to the fact that approximately SDR 57 million was needed for the 1986 financing gap.

Mr. Goos said that whereas he had been prepared to go along with an outright approval, an unfinanced gap in the program would cause him difficulties. Therefore, the use of the reserves to close the financing gap might be considered at least as a temporary though unsatisfactory option. After all, the time until the November drawing was only two months. In November, the Board should consider the question of the financing gap. He was quite confident that a solution could be found in time, in particular since several Directors had already indicated that they were prepared to help close the gap. The Board should not discard the possibility of using part of the reserves in the meantime.

Mr. Foot considered that there was no immediate financing cash flow obstacle to the program, and the Board needed time to sort out a longer-term strategy. Furthermore, if the Board adopted a principle that was based on a concern for Fund liabilities, there would be few African programs in existence. Indeed, there were other cases in which operative programs should be recalled. However, that had not been the course that the Board had taken. Many of the financing gaps that had been approved and accepted were higher and would take more than two months to close. He agreed with Mr. Zecchini, therefore, that the issue needed to be considered in a general context, perhaps in a staff paper. Nevertheless, for Zaïre's immediate viability, an outright approval appeared to be the preferable solution, even while accepting the fact that there was a very real problem.

The Chairman remarked that with the upcoming donors' meeting in Washington, the Fund should not shy away from disquieting figures for 1986 financing gaps because they were small margins and consider that they were only a 1987 problem.

Mr. Parmena said he wondered whether the staff might comment on the possibility of a compensatory financing facility arrangement.

The Deputy Director of the African Department stated that regarding a compensatory financing facility arrangement, it was clear that a sizable shortfall in export earnings would occur in 1986. The staff as yet did not have a final figure for 1986.

The staff representative from the Exchange and Trade Relations Department noted that the Board would have to be quite satisfied with cooperation under the stand-by arrangement when looking into the question of an arrangement under the compensatory financing facility and how it would fit into the requirements of Zaïre.

The Chairman noted that the Board was not leaning toward an approval in principle. Therefore, something more immediate would be decided. However, he had many concerns about the question, not only in the case of Zaïre but as a more general issue. Mr. Polak had made an interesting point when he had compared the issue with the Board's previous approach to Latin America. However, whereas the Fund had not considered its contribution to Latin American countries as a financing item, it had led to difficult problems with the commercial banks because they had asked why the Fund should be contributing to the reinforcement of those countries' reserves. In the process, the Fund had protected its position as well as the reserve position of those countries, and as a result, those countries had strengthened their external position. In the case of Africa, the Fund was more lenient perhaps because it was dealing in most cases not with banks but with governments--although frequently the governments said the same thing as the banks. Indeed, several speakers had said the same thing that morning. In other words, the banks and the governments say the same thing that Mr. Foot had said, that the country was a Fund contributor and therefore it did not need to retain large reserves. However, that was not true. The Fund was there to strengthen the external position of the country, but it had to protect its own repayability.

There should be a global discussion on the question because it was possible that the Fund and the African countries would be left in a very difficult position that might eventually be arbitrated by the governments and the donors, the Chairman said. In some cases in Africa the reserve position was institutionally strong because of the arrangements within the French franc system. Therefore, in order to establish an evenhanded basis for all African countries, the Board was going to have to study the question in depth.

Ms. Bush considered that it was her chair's position to go with the waiver and the disbursement as had been suggested but with strong reservations because an approval in principle with a later consideration after the donors had addressed the financing gap would have been better. It was essential that the donors address the problem of the financing gap in a week or so.

Mr. Leonard remarked that because a most convincing case had been made on the need to move forward at the moment, his chair supported the decision.

Mr. Mawakani said that the Board action would pave the way for Zaïre to continue to tackle the other financial problems confronting the country, and therefore he was grateful for it. Speakers had emphasized the difficult economic and financial prospects projected for the remainder of 1986 and 1987, a reflection of the unfavorable outlook for the prices of Zaïre's export commodities--especially cobalt, coffee, and copper. Moreover, Zaïre's economic prospects were expected to be brighter if substantial improvement in those prices occurred. In light of the uncertainty that such a change would take place, he hoped that Zaïre's donors and creditors would again consider and provide generous support for the authorities continuing adjustment efforts. Therefore, his authorities looked forward to discussions during the Annual Meetings in order to be certain about the 1987 financing gap.

The Executive Board then took the following decision:

1. Zaïre has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Zaïre (EBS/86/76, Sup. 2, 5/1/86) and paragraph 4 of the letter dated March 28, 1986 from the President of Zaïre attached to the stand-by arrangement, in order to reach understandings subject to which Zaïre may make further purchases under the stand-by arrangement.

2. The communication dated September 18, 1986 from the Governor of the Bank of Zaïre shall be attached to the stand-by arrangement and the letter of March 28, 1986 shall be read as supplemented and modified by the communication dated September 18, 1986. Accordingly, the performance criteria for end-September 1986 referred to in paragraph 4(a)(i), (ii), and (vi) are modified as specified in the communication of September 18, 1986.

3. The Fund decides that, notwithstanding the nonobservance of the end-June 1986 performance criteria on net domestic assets of the banking system and on net credit to the Government by the domestic banking system, Zaïre may proceed to make purchases under the stand-by arrangement, provided that purchases under the stand-by arrangement shall not exceed SDR 47.6 million until completion of the first review under the stand-by arrangement.

Decision No. 8414-(86/162), adopted
September 24, 1986

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/161 (9/22/86) and EBM/86/162 (9/24/86).

4. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/86/223 (9/16/86) concerning an extension of leave without pay for a staff member.

Adopted September 23, 1986

5. <u>EXECUTIVE BOARD TRAVEL</u>

Travel by Executive Directors as set forth in EBAP/86/225 (9/22/86) is approved.

APPROVED: June 5, 1987

LEO VAN HOUTVEN
Secretary