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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/102

3:00 p.m., June 29, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	T. Ramtoolah, Temporary
	G. Ercel, Temporary
	X. Blandin
A. Donoso	
	M. K. Bush
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	D. I. S. Shaw, Temporary
A. Kafka	H. A. Arias, Temporary
	G. Grosche
	N. Coumbis
R. N. Malhotra	
	J. E. Suraisry
	A. A. Scholten, Temporary
A. R. G. Prowse	
	A. A. Agah, Temporary
M. A. Senior	
	E. I. M. Mtei
	A. Lindø
	T. A. Clark
	Wang E.

J. W. Lang, Jr., Acting Secretary
S. J. Fennell, Assistant

Also Present

Administration Department: R. Tenconi, Director; T. Cole, J. B. Kaiser, W. B. Hobbs, J. D. Huddleston, P. D. Swain. Asian Department: Tun Thin, Director; H. Neiss, Deputy Director; C. M. Browne, D. Burton, M. R. P. Salgado, A. Singh. Exchange and Trade Relations Department: M. Guitian, Deputy Director; J. Berengaut, Y. Boutros-Ghali. Fiscal Affairs Department: O. Pettersen, A. A. Tait. Legal Department: J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman, A. O. Liuksila. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; C. Cha, C. M. de Rosa, R. A. Elson. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. E. Conrado, S. El-Khouri, L. Ionescu, H.-S. Lee, W. Moerke, G. E. L. Nguyen, I. R. Panday, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: I. Angeloni, R. L. Bernardo, J. Bulloch, Chen J., V. Govindarajan, D. Hammann, N. U. Haque, J. M. Jones, A. K. Juusela, H. Kobayashi, M. Lundsager, E. Portas, M. Rasyid, J. Reddy, A. J. Tregilgas, A. Yasseri.

1. PHILIPPINES - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/84/101, 6/29/84) their consideration of the restricted staff report for the 1984 Article IV consultation with the Philippines (EBS/84/117, 5/29/84; Cor. 1, 6/27/84; and Sup. 1, 6/22/84). They also had before them a report on recent economic developments in the Philippines (SM/84/132, 6/13/84; and Cor. 1, 6/27/84).

The Executive Board, upon the conclusion of its discussion, took the following decision:

1. The Fund takes this decision relating to the Philippines's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with the Philippines, in the light of the 1984 Article IV consultation with the Philippines conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that the Philippines maintains a comprehensive system of exchange restrictions, including: (a) the requirement of prior approval by the Central Bank for foreign exchange sales for specified imports and other payments, which is not automatically provided; (b) the indefinite suspension of foreign exchange applications for imports for specified products; (c) payments arrears with respect to current international payments and transfers; (d) limits established by the Central Bank on foreign exchange sales for specified invisible payments; and (e) a tax on foreign exchange purchases for nonmerchandise imports, which was introduced on June 6, 1984. The Fund urges the Philippine authorities to adopt policies that would permit the early removal of these restrictions.

Decision No. 7746-(84/102), adopted
June 29, 1984

2. GUATEMALA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Guatemala (SM/84/127, 6/4/84). They also had before them a report on recent economic developments in Guatemala (SM/84/139, 6/19/84; and Cor. 1, 6/20/84).

Mr. Senior made the following statement:

Even though it was not possible to complete the review of the current stand-by arrangement on schedule, the consultation discussions were very helpful to analyze thoroughly the Guatemalan economy and to set out the differing perspectives regarding its performance in 1984. While the authorities concur with part of the staff appraisal regarding prospective economic performance during 1984 and on the possible need to adopt some corrective measures now, they would like to see more developments in the economy before undertaking drastic actions to strengthen substantially the current adjustment effort. In this regard, they would prefer to study and develop a more comprehensive set of measures that would be consistent with their objective of restoring internal and external equilibrium in the Guatemalan economy, rather than to deal with imbalances in a partial way. The authorities are continuing to study alternative policy measures that might be adopted in case the economic and financial situation deteriorates significantly. In the present social, political, and economic circumstances, however, the authorities do not consider it feasible to adopt immediately further strong adjustment measures, in particular, to increase taxes.

In August 1983 the Board approved a 16-month stand-by arrangement with Guatemala which runs through the end of 1984. The main objectives of the program are to stabilize the balance of payments position of Guatemala in the medium term, restore the country's access to international capital markets, and set the basis for export-led sustainable growth in the future. The program was therefore structured to render equilibrium in the balance of payments in 1983, reduce arrears substantially, and bring aggregate demand in line with the depressed supply conditions resulting from exogenous forces. During 1983, performance under the program was basically on line. The overall balance of payments improved significantly, registering a surplus of $31 million, and arrears were reduced more than envisaged in the program. Moreover, Guatemala observed all performance criteria, although the improvement in the overall fiscal position was somewhat less than envisaged in the program, mainly because of a rather weak revenue performance.

As indicated in the staff report, until May 11, 1984, Guatemala was in compliance with all performance criteria, with the exception of the limit on the outstanding balance of payments arrears. This deviation was mostly a technical one, however, as the corresponding limits are set on a quarterly basis at the beginning of each quarter, so that the gradual scheduled reduction of arrears would normally bring about compliance with the limit only toward the final part of each quarter. The latest available figures show that, to date, Guatemala is observing all quantitative performance criteria, as can be seen in the following table.

	1983	1984	
	Dec. 31	Mar. 31	June
	(In millions of quetzales)		
Net domestic assets of the monetary authority			
Program	724.1	719.1	714.1
Actual	705.6	713.5	677.7 1/
Net indebtedness of the non-financial public sector with the domestic banking system			
Program	1,485.0	1,515.0	1,545.0
Actual	1,399.0	1,491.8	1,538.2 2/
Outstanding balance of payments arrears			
Program	294.1	269.1	244.1
Actual	286.0	267.7	243.6 1/
	(In millions of U.S. dollars)		
New foreign loans contracted by the public sector			
One- to five-year maturity			
Program	150.0	150.0	150.0
Actual	6.0	26.0	36.0 3/
One- to ten-year maturity			
Program	300.0	300.0	300.0
Actual	6.0	26.0	36.0 3/

Source: Banco de Guatemala.

1/ Figures to June 15, 1984.
2/ Figures to June 8, 1984.
3/ Figures to May 31, 1984.

The authorities wish to reaffirm strongly their commitment to adhere to the program and to the strict observance of all performance criteria. On the basis of their expectations regarding performance in the different areas of economic policy, they consider that they will be able to stay within all the specified limits for the remainder of the year, and have therefore adopted a cautious approach to the introduction of further corrective adjustment measures.

While the authorities consider that there might not be either an immediate need or a real possibility of departing drastically from current economic policy, there is room for some adjustment, especially in the fiscal area. In this regard the authorities are implementing a number of measures to increase revenues and further cut expenditure. These measures, in their judgment, will substantially reduce the expected overall public sector deficit and will bring it more in line with the program's target. On the revenue side, these measures include better tax administration and the collection of extraordinary revenues through fiscal amnesty, administrative improvements in the real estate tax, publicity campaigns, increased and improved external audits, and better controls in customs. More important, in the area of expenditure, further reductions are being planned that will bring their total to Q 1,034 million in 1984, a level that is slightly lower than last year's, and that represents a reduction in nominal expenditures for the fourth consecutive year. The Guatemalan authorities have amply demonstrated their commitment and ability to reduce expenditure in order to improve the country's fiscal situation. The attainment of the aforementioned level of expenditure would be brought about mainly through a reduction in capital expenditure, as a result not only of a preplanned cut in investment, but also of a very low execution rate in ongoing projects and a shift toward the development of smaller projects, rather than larger ones that have already been completed. Current expenditure will also be reduced in real terms. The authorities, while concurring that there is a strong need to increase revenues on a sustained basis in the medium term, consider that at present they are not in a position to increase current tax rates or introduce new taxes in Guatemala; they would defer any actions in this area at present.

In the area of monetary policy, the authorities intend to continue their current prudent policy stance. In this regard, the monetary policy recently approved by the monetary authorities has reaffirmed their commitment to maintain bank financing of the public sector within the program's limits, and to finance private sector activities at levels that would also be consistent with the program and with the financing needs of the productive sectors.

In the authorities view, interest rates should and will be managed flexibly. This does not mean, however, that variable interest rates will necessarily be introduced in Guatemala. The present system affords sufficient flexibility to adjust lending rates rapidly, and deposit rates with somewhat of a lag, as has been demonstrated in the past. Nevertheless, the authorities will continue to study the staff's suggestion to eliminate Article 101 of the Bank of Guatemala Law, which does not allow for retroactive interest rate increases to existing loans. The elimination of this Article, while allowing for the possible introduction of variable interest rates in Guatemala, would not be sufficient for such a modification in the present system of fixed-rate loans. In any case, as most of the present financing is made on a relatively short-term basis, rates can be adjusted rapidly even within the system of fixed-rate loans.

As to short-term foreign borrowing by commercial banks, the authorities agree with the staff that it should be brought under stricter control by the monetary authorities. The authorities, however, do not consider present levels excessive, nor short-term foreign borrowing as being undesirable. Given the marked seasonality of exports and international reserves in Guatemala--as a consequence of the structure of production and exports in the country--short-term foreign borrowing by commercial banks has an important role to play in stabilizing reserves throughout the year. Such financing reinforces foreign exchange inflows during the second and third quarters of the year when imports are high and exports low, and repayment is carried out in the first quarter of the following year when reserves are growing as exports increase substantially. This seasonal pattern is characteristic of the Central American countries, and I have alluded to it on several previous occasions. As long as short-term borrowing is basically financing the imported-inputs content of exports, there should be no reason for concern, and it serves the useful purpose of stabilizing reserves. The high rate of growth of short-term borrowing in the past few years is mostly a consequence of Guatemala's rather limited use of this instrument in the past, when the country's reserves were among the highest in the world in relation to its imports.

The current stand-by arrangement with Guatemala included, besides the usual quantitative performance criteria, two specific qualitative criteria as well. One of these called for the introduction by January 15, 1984 of a bona fide clause for invisible payments abroad, excluding business travel; Guatemala has been in full compliance with this performance criterion since February 1984. The other specific qualitative performance criterion called for a review by May 31, 1984, with a view toward eliminating the remaining exchange restrictions before the expiration of the stand-by arrangement. The mission that went to Guatemala for the consultation was also to complete this review, and to that purpose it suggested that the authorities should adopt a series of major measures in the fiscal, monetary, and trade areas, which would reassure the staff of the sustainability of the understandings that could be reached in the scheduled elimination of exchange restrictions. While the authorities consider that even now they would be ready to reach understandings regarding the elimination of restrictions, for the reason explained before they indicated that for the moment they could not adopt the major adjustment measures proposed. In their view, understandings could be reached even in the absence of such measures, given an adequate schedule of reduction in restrictions. The authorities in any case would consider concluding the review at a later stage if compliance with the quantitative performance criteria is maintained--as such compliance would indicate that adjustment is being undertaken as originally programmed--in order to resume purchases, under the stand-by arrangement. These purchases are considered necessary to continue the scheduled reduction of payments arrears in the future, and were contemplated as such in the stand-by program.

In conclusion, the authorities consider that the process of consultations with the Fund is very important, and they have maintained a continuous dialogue with the staff.

Mr. Arias stated that the 16-month stand-by arrangement adopted by the Guatemalan authorities in mid-1983 had aimed at stabilizing the balance of payments position. He congratulated the authorities on reaching a balance of payments surplus of $31 million in 1983 and on reducing the outstanding external arrears by more than had been programmed.

Prospects for 1984, however, indicated a deterioration with respect to performance in 1983, Mr. Arias noted. The current account deficit was expected to widen and the overall balance of payments was expected to register a deficit, even though Guatemala was observing the performance criteria under the arrangement. Could the staff comment on why Guatemala might not attain the objectives of the stand-by arrangement for 1984? It was essential to know the reasons if he was to make a judgment on the real need for stronger additional measures to support the current adjustment effort.

The fiscal situation had deteriorated, as revenues had not been as high as predicted, and reserves would remain lower than projected in 1984, Mr. Arias observed. While he could appreciate the authorities' efforts to contain and reduce expenditure, such a strategy did not seem appropriate for the medium term. Guatemala's tax/GDP ratio was one of the lowest in the world, and it had been falling in the past two years. Clearly, expenditure could not be continuously compressed; only an increase in revenues could guarantee a sustainable fiscal improvement in the future. He took note of Mr. Senior's comments regarding the measures taken by the authorities to increase revenues, but would those measures be sufficient to cope with current imbalances? It might be desirable to increase the value-added tax to former levels, an action that would be extremely helpful in the adjustment effort. Furthermore, it would allow for the increase in capital expenditure, which was necessary if the authorities were to avoid a marked deceleration in the overall growth of the Guatemalan economy.

As for monetary policy, he concurred with the staff that the recent weak savings performance should be reversed, Mr. Arias continued. The authorities should introduce greater flexibility in interest rate determination to encourage financial savings and better allocation of resources. In the absence of such flexibility, the authorities should at least move toward increasing current rates, not only to increase savings but also to contain capital outflows and demand for credit. Finally, he welcomed the recent action taken to eliminate some exchange restrictions.

Mr. Donoso remarked that there were many indications that the actions undertaken by the Guatemalan authorities to improve the economic and financial situation of the country had been successful. Following three consecutive annual balance of payments deficits in excess of $300 million, the authorities had achieved a balance of payments surplus in 1983. That improvement reflected both a drastic reduction in the current account deficit from 6.7 percent of GDP in 1981 to 2.8 percent of GDP in 1983, and a lower level of net private capital outflows. The imbalance in the nonfinancial public sector had been reduced during 1983, although to a lesser degree than expected under the Fund-supported program.

Even though credit to the private sector had increased at a faster rate than originally contemplated, credit to the public sector remained lower than projected, and the overall expansion of credit had therefore been restrained, thereby keeping the current account deficit under control and facilitating the financing of the budget deficit, Mr. Donoso observed. The attraction of short-term capital had facilitated the achievement of an overall balance of payments surplus. The improvement in the external account reflected a serious effort on the part of the authorities, even though GDP had declined during 1983 for the second consecutive year and investment and national savings had continued to decrease.

He was concerned about the staff projection of a deterioration of the economic situation in 1984, as a result of an expected weakening of the fiscal position, Mr. Donoso commented. Given the poor growth of holdings of financial assets and the strong demand for credit from the private sector, the financing of the public sector deficit threatened to aggravate the monetary situation and, thus, the current account of the balance of payments. The latest projection of inflows of official capital indicated that the higher current account deficit would once again cause a large deficit in the balance of payments.

He welcomed the authorities' intention to reduce current public expenditure, Mr. Donoso said. However, he shared the staff's view that the authorities should not overestimate the possible results of such action. Efforts should be made to maintain investment, which would be affected if the planned revenue measures and cuts in current expenditure were insufficient to correct the public sector imbalances.

Given the projected delicate external account position, the authorities should act decisively in the area of public finance and should consider a fundamental review of the tax structure, as proposed by the staff, Mr. Donoso continued. Firm action was required to deal with the monetary situation, and he welcomed the recognition by the authorities of the need to reduce the rate of credit expansion to the public and private sectors. He agreed that it was necessary to stimulate the growth of holdings of financial assets by increasing interest rates. Nevertheless, interest rate management had been relatively flexible, facilitating a reduction in private capital outflows and making it attractive for commercial banks to encourage short-term capital inflows from abroad. He would appreciate staff comment on that matter.

On the external side, the projected increase in exports during 1984 after three years of decline was most welcome, Mr. Donoso commented. However, imports were projected to rise faster, and interest payments would also increase owing to a high level of commercial debt and interest payments on external arrears. The projected increase in the current account deficit was worrying, especially as capital inflows were expected to be lower than projected. He could support the staff's view that strict fiscal and monetary policies should be pursued in the remainder of 1984 to strengthen the external accounts.

He noted from Mr. Senior's statement that the authorities' perception of the future evolution of the economic situation in Guatemala was different from that of the staff, Mr. Donoso remarked. They considered that their planned fiscal and monetary policies, though less strict than those proposed by the staff, would be sufficient to maintain the adjustment of the economy according to the original program. That difference of opinion had precluded the completion of the review contemplated under the stand-by arrangement. The latest available figures indicated that Guatemala had observed all quantitative performance criteria to date. The authorities had strongly reaffirmed their commitment to the program and to future compliance with the performance criteria. Since February 1984, after a delay of one month, the authorities had liberalized exchange transactions relating to invisibles, and they were ready to reach an understanding regarding the elimination of the remaining exchange restrictions. The problem hindering the completion of the review therefore seemed to be the staff's view that the elimination of restrictions might not be sustainable unless tighter fiscal and monetary policies were pursued. The staff apparently wished the authorities to reconfirm their commitment to comply with future performance criteria; that was not, however, the purpose of the review. Could the staff clarify its statement that the authorities did not want to commit themselves to a schedule of elimination of restictions?

In general, drawings from the Fund should not be dependent on assumptions about the future, but on compliance with objective criteria, Mr. Donoso said. If the purpose of the review was to define a schedule for the elimination of exchange restrictions, and the authorities were willing to agree on a reasonable schedule and had complied with other criteria, the drawings should be resumed; there would be reason to suspend purchases only if future performance criteria were not met. He did not believe that the staff was treating the performance criteria under the stand-by arrangement with Guatamala in that manner. It would be helpful if the straff could clarify what appeared to be contradictory views between the staff and authorities on the operation of the review requirement.

Mr. Scholten said that he recognized that present circumstances in Central America made it difficult for any country in the region facing balance of payments difficulties to go beyond a holding operation to achieve successful and sustainable adjustment. Nevertheless, it was in support of such adjustment that a stand-by arrangement for Guatemala had been approved. He agreed with the staff appraisal and the staff's position with respect to the review under the stand-by arrangement.

He was concerned, first, about fiscal developments under the stand-by arrangement, Mr. Scholten remarked. In August 1983, the Executive Board had approved the arrangement on the basis of the authorities' stated commitment to follow, without modification, the recently enacted fiscal reform. Shortly thereafter, however, there had been a substantial reduction in the value-added tax and a significant increase in tax exemptions. As a result, the projected increase in revenues would not be achieved. While observance of the performance criterion regarding public sector financing by the domestic banking system justified further purchases, he considered that the tax issue was important. The original target for tax revenues in 1984 had been 8.1 percent of GDP, 50 percent above the present estimate of 5.4 percent of GDP. That difference was not small and had an important bearing on structural aspects of the adjustment program.

Second, he was concerned about the divergence between domestic interest rates and dollar interest rates, which affected domestic savings and enhanced the attractiveness of the parallel exchange market, Mr. Scholten continued. Could the staff comment on recent developments in that market, its growth and size, as well as the authorities' success in restricting that market, in order to shed some extra light on the prospects for the intended liberalization of the exchange system at the official rate and on the barriers still to be overcome?

In sum, he could support the authorities' desire to continue pursuing the present arrangement aimed at restoring financial stability at the official exchange rate, but appropriate fiscal and monetary policies should be adopted, Mr. Scholten considered. However, if the program was not successful in securing a sustainable external balance, the starting point--maintaining the official exchange rate--should be re-examined, as perhaps had been implied by Mr. Senior when he mentioned that alternative policy measures were being studied.

Ms. Bush expressed her disappointment that the 1984 Article IV consultation with Guatemala was taking place without the review of the stand-by arrangement, owing to the inability of the authorities to implement some of the measures agreed upon when the stand-by had been approved in August 1983. Guatemala had not yet reached the crisis point, but the current hesitation in implementing adequate microeconomic policies could slow the already inadequate rate of private and public saving, cause an unnecessary erosion in the rate of economic growth, further weaken the balance of payments position, and lead to the accumulation of additional arrears.

While it was clear from Mr. Senior's statement that all performance criteria had technically been met thus far, the major problem of the shortfall in government revenues remained, Ms. Bush continued. The consequently larger than projected fiscal deficit had caused the authorities to continue with and add to restrictions on economic activity, that, if maintained, would result in entrenched distortions in the economy. On a related point, she was concerned about the continuation of exchange and trade controls. A flexible management of the official exchange rate, or legalization of the parallel market, would be a more efficient means of restraining imports and encouraging exports. Her chair had raised those concerns at EBM/83/77 (6/1/83), and their importance had only increased during the course of the year.

She basically agreed with the staff appraisal, Ms. Bush went on. The large shortfall in government revenue had led the authorities to tighten both current and capital expenditure. In general, she would encourage expenditure control, but the collection of tax arrears could help to increase revenues. The growing fiscal deficit was straining the financial sector and hindering the monetary authorities' ability to limit total credit expansion while providing adequate credit for private investment. In addition, Guatemala's low or negative real interest rates had discouraged private saving and distorted private investment. She urged the Guatemalan authorities to raise real interest rates to significant positive levels. She hoped that, in shifting investment priorities from large projects to small-scale projects with high socioeconomic impact, the authorities would give adequate weight to the need for any investments to be both productive and profitable.

While tighter demand management was necessary to maintain long-term balance of payments equilibrium, Ms. Bush continued, Guatemala could soften the impact of such a policy on its domestic economy by managing its official exchange rate flexibly or by allowing broad access by exporters to the parallel market. The Guatemalan authorities were reportedly well aware of the need to promote exports to provide a base for future economic growth and debt service payments. She suggested that they should implement an appropriate exchange rate policy in lieu of the mix of fiscal incentives aimed at stimulating exports. Flexible management of the exchange rate would also dampen demand for imports, allowing the authorities to dismantle the existing comprehensive exchange control system, which could only result in growing distortions in the allocation of resources.

Inadequate control over domestic demand and an insufficiently flexible exchange rate policy had contributed to the accumulation of external arrears, which had hurt Guatemala's creditworthiness, Ms. Bush observed. She strongly urged the authorities to implement the measures necessary to strengthen the adjustment effort as soon as possible. Prompt action would then permit a review of the stand-by program and the resumption of drawings. Could the staff or Mr. Senior give their most recent assessment of Guatemala's prospects for a return to its adjustment program?

The staff representative from the Western Hemisphere Department confirmed that the latest information available to the staff indicated that Guatemala was in compliance with all the quantitative performance criteria of the current stand-by arrangement. However, Guatemala's performance under the program in the last three months had not been consistent. For example, the net domestic assets of the Bank of Guatemala had exceeded the program ceilings from the beginning of April through the first week of May, before being reduced below the ceilings. Guatemala's current compliance with the program ceiling on bank credit to the public sector was due, to a large extent, to the wide margin under the ceiling achieved at the end of 1983. That margin had been made possible only by the nonfinancial public sector's heavy use of nonbank domestic financing, including advance tax collections, bond placement, and an increase in pending bills. For the first five and one half months of 1984 the use of bank credit by the public sector had amounted to about Q 130 million--or about three fourths of the total allocation of bank credit to the public sector for the entire year--compared with Q 60 million allowed for the program.

Looking ahead, developments in the first few months of 1984 indicated that there would be a further deterioration in the financial system in 1984, the staff representative went on. One of the performance criteria required that the authorities and the staff should reach an understanding on the liberalization of the existing exchange restrictions. The exchange quotas for imports were the most important restriction currently in place. At the time of the staff visit to Guatemala, the authorities had been unable to discuss the details of the liberalization of the existing restrictions. It had been agreed with the authorities that the consultation would be completed at that time, but that a review of the program would be discussed at a later date.

The parallel market represented about 20-25 percent of total foreign exchange transactions in Guatemala, the staff representative said. The rate in the parallel market had been fluctuating between Q 1.20 and Q 1.50 to the U.S. dollar. The real effective exchange rate had appreciated by about 15 percent in the past three years, primarily because the Guatemalan quetzal was pegged to the U.S. dollar, which had appreciated during that period. However, in terms of the competitiveness of exports, the present exchange rate might be appropriate, as the export tax had been reduced in mid-1983 and additional fiscal incentives had been given to exporters. Nevertheless, competitiveness should also be evaluated in terms of the developments in the balance of payments.

The adjustment prospects in Guatemala in the coming months depended on what measures the authorities would be willing to take, the staff representative stated. At present, the Guatemalan authorities were focusing their adjustment efforts on reducing investment expenditure and restraining credit expansion by the Bank of Guatemala. Those measures, while important, were short of what was necessary. There was a possibility that the authorities might rely more on foreign borrowing, but in the absence of very strong revenue measures, the situation would deteriorate further.

Responding to a question from Mr. Donoso, the staff representative from the Western Hemisphere Department indicated that the improvement in short-term capital movements in 1983 had been affected by the recovery of confidence in the private sector, following the authorities' decision to reduce payment arrears, and was not directly related to the level of interest rates. Furthermore, the agreement with the Fund on a stand-by arrangement would have had a favorable effect on capital movements. The appropriateness of interest rates should be viewed with respect to domestic savings and credit expansion, and international capital movements. There was reason to believe that interest rates should be adjusted upward because domestic financial savings were increasing at a rate of no more than 2 percent a year, while credit to the private sector was increasing at a rate of about 13 percent a year. Interest rates on deposits in Guatemala varied from 5 percent to 8 percent, while international interest rates were much higher.

Mr. Shaw noted that the staff had not proposed approval for the retention of the remaining exchange restrictions. The Executive Board had decided on August 31, 1983 (EBM/83/126) to grant approval of the restrictions until May 31, 1984 or the time of the mid-term review of the stand-by arrangement, whichever was earlier. If the Executive Board did not approve the exchange restrictions at the present meeting, what was the status of the original decision on the exchange restrictions?

The Deputy Director of the Exchange and Trade Relations Department stated that no decision was needed. The earlier approval of the exchange restrictions had lapsed on May 31, 1984.

Responding to a question from Mr. Donoso, the Deputy Director commented that the completion of the review was a performance criterion under Guatemala's stand-by arrangement. At the time of the staff visit to Guatemala, the authorities had not indicated the date on which they would be eliminating the exchange restrictions. He understood that they felt unable to formulate their domestic policies for the remaining period in ways that would be consistent with the elimination of the restrictions. Only after policies had been formulated for the remainder of the arrangement could the path of liberalization be discussed.

Mr. Donoso stated that he understood the position of the authorities to be different. To take a hypothetical case, what would their situation be if they had been willing to commit themselves to a schedule of elimination of restrictions because they had formulated their policies for the remainder of the program, and the staff considered that those policies would not enable the elimination of restrictions in the manner contemplated.

The Deputy Director of the Exchange and Trade Relations Department stated that if a program was well formulated, the performance criteria were being observed, and the authorities were willing to agree on a given path of liberalization, the review of the program could be completed. The staff would make an assessment of whether the path of liberalization was feasible. Although the performance criteria had been observed by the authorities thus far, there was not much indication that the policies were on track: for example, several of the ceilings had been exceeded, or had been met by nonbank domestic financing. During the discussions between the staff and the authorities it had been clear that the prospects for successful implementation of the adjustment policies during the remainder of the arrangement were not favorable. Hence, the staff had concluded that, as it was unlikely that the authorities would liberalize the exchange restrictions to the extent necessary, the review should not be carried out at that time. If the authorities indicated their willingness to discuss the liberalization of the exchange restrictions, the staff would have further discussions with them and would present another proposal to the Board.

Mr. Senior remarked that Guatemala's case was particularly interesting because, although it had observed fully all the quantitative performance criteria, the staff had considered that the program was off track. Nine months had passed since the stand-by arrangement had been approved, and the staff had had ample time to assess properly the evolution of the program. The authorities considered that they could meet the future performance criteria, and they had reaffirmed their commitment to adhere to the adjustment program. At a recent Board discussion on reporting problems, the case of a country that had observed all quantitative performance criteria but had not been allowed to draw on the Fund's resources had been touched on. As cases of that kind were occurring more frequently, the issue should be discussed at greater length in the future. In the view of his authorities, an agreement could be reached on the elimination of exchange restrictions without the need for a total modification of the program.

If all performance criteria were observed, the Executive Board should re-examine the member's case in order to allow it to make purchases, Mr. Senior said. Guatemala needed Fund resources to continue the scheduled reduction of arrears; otherwise, all the gains that had been made in restoring the confidence of external creditors and investors in the country would effectively be canceled out. According to the most recent figures--even more recent than those of the staff--Guatemala was still observing all performance criteria on June 22, 1984.

His authorities were basically in agreement with those Directors who had referred to the need to introduce some adjustment measures in the fiscal and monetary areas, Mr. Senior remarked. In the present circumstances, his authorities did not consider that they were in a position to substantially increase taxes or introduce new taxes; however, they were keeping an open mind. The authorities were seeking other ways to stabilize and strengthen the fiscal situation, and their ability to deal with expenditure restraint had been amply demonstrated in the past.

The Chairman made the following summing up:

> There was general agreement with the thrust of the appraisal in the staff report for the 1984 Article IV consultation with Guatemala. Directors noted that performance in 1983 under the

current stand-by program was mixed, even though Guatemala had met at the latest date all the quantitative performance criteria. The financial outcome was generally more favorable than in 1982 and a balance of payments surplus had been achieved, although the underlying external position remained weak. Directors noted with concern the emergence of slippages in fiscal performance as a result of the reduction in the rate and the scope of the value-added tax, which was a key element of the stabilization program. It was noted that there had been some exceptional borrowing from domestic nonbank sources by the Central Government and short-term foreign borrowing by the commercial banks, which had facilitated the Government's compliance with the credit limits and with the balance of payments targets of the program last year.

To avoid a further deterioration in the economic situation in 1984 and to ensure the achievement of the objectives of the program, Directors considered it essential that Guatemala introduce without delay corrective measures in the fiscal and monetary areas. In view of the declining trend in public sector revenues and savings in recent years, Directors emphasized the importance of tax measures to strengthen the fiscal position on a more lasting basis. Such measures should be designed to provide revenues sufficient to compensate for the loss arising from the changes made last year to the value-added tax. Directors were generally of the view that continued reliance on expenditure restraint alone, especially on the capital side, would be inadequate to achieve the fiscal objectives of the stand-by program.

Directors concurred with the authorities' intention to pursue a more restrictive credit policy but stressed that it should be accompanied by a more flexible management of interest rates, which must be positive in real terms in order to dampen credit demand, encourage private financial savings, and alleviate exchange market pressures. In this connection, some Directors considered it important to limit the use of short-term foreign borrowing by domestic commercial banks.

Given the recent deterioration in Guatemala's debt profile and its debt service prospects over the next few years, the authorities should exercise caution in their domestic demand management and in contracting new foreign loans. The importance of promoting the growth of exports was also emphasized.

Directors welcomed the reduction in external payments arrears that had been accomplished last year and the recent liberalization of restrictions on invisible payments abroad. It was hoped that the authorities would soon be in a position to adopt the adjustment measures, including a flexible management of the exchange rate policy, that would facilitate the needed liberalization of the remaining exchange restrictions as contemplated under the existing stand-by arrangement.

It is expected that the next Article IV consultation with Guatemala will take place within the standard 12-month cycle.

Mr. Senior said that the reference to nonbank and foreign short-term borrowing by the Guatemalan authorities in 1983 suggested to him that the fact that Guatemala was observing all performance criteria should also be mentioned.

The Chairman took note of Mr. Senior's suggestion and said that the Executive Board would have to agree with the authorities on a realistic path for the elimination of the exchange restrictions. The staff was concerned that, if the appropriate policies were not pursued, the liberalization of the exchange restrictions would be a shock to the economic system, causing the adjustment program to go off track.

3. OFFICE SPACE - LEASE AT 1875 I STREET, N.W.

The Executive Directors considered a staff paper on proposed leasing of office space (EBAP/84/129, 6/13/84).

Mr. Arias stated that he was prepared to support the staff recommendation in principle. However, he had a number of questions. How much space would the Fund be leasing altogether? The space to be leased was expected to serve a variety of needs; could the staff provide a breakdown of the Fund's need for space against the space that was still available at headquarters, that was already under lease, and that was to be leased? He would have liked to have seen a comparison of the Fund's space standards for staff members and Executive Directors, compared with the standards applied by other organizations.

Mr. Blandin observed that there were presently 36 surplus offices available at headquarters, plus an additional 14 surplus offices that were in almost constant use. The space that the Executive Board was considering for lease was composed of 9 offices and 2 reception areas. Even if the surplus offices at headquarters were used instead of the space proposed for lease, 25 offices would still remain. Was that not a sufficient number? It should not matter that the 36 surplus offices at headquarters were unevenly distributed between floors, particularly as the staff had stated that "it is envisioned that the space would be allocated for individuals or small self-contained units." Although the Fund might have a good opportunity to lease space at International Square, would the lease be compatible with the staff's medium-term projections of office needs?

Mr. Shaw inquired whether the proposed lease would be coterminous with the present leasing arrangements, and whether the cost had been included in the budget for financial year 1985?

Ms. Bush reminded Directors that her chair had mentioned at EBM/84/66 (4/25/84), in the context of the administrative budget, the need for the Executive Board to take a long-term perspective of the budgetary process insofar as it concerned specific properties and the cost implications of policy decisions made by the Board. It would be better to develop a plan for medium-term personnel and space needs on which to base requests. Did the staff consider that there was sufficient coordination between the personnel office and space planners, or was more coordination required? While she recognized that actual costs and needs would differ from projections, a framework for decision making would exist if the staff developed a medium-term plan. With regard to the proposed decision, she noted that $10 per square foot was suggested as the amount necessary to prepare the space for occupancy. What was the basis for that number? Was the rental cost of $26 per square foot a firm price, or a maximum within which the Fund could negotiate?

Mr. Agah commented that in the past his chair had asked the staff about the possibility of examining the costs and benefits of moving the World Bank and the Fund outside Washington. That issue was particularly relevant as it was becoming more difficult and expensive to rent space, a factor that the staff had used as justification for proposing to lease space at International Square. It would perhaps be lucrative for the Fund to conduct its business outside the city, where the cost of land and maintenance was less expensive, and to rent its present headquarters.

The Director of the Administration Department stated that it was difficult for the staff to formulate a medium-term plan, as it did not have a clear view of staff requirements in two or three years' time. However, the staff considered it most appropriate to lease any space that became available at International Square because it was advantageous to have all office space outside headquarters located in the same building, owing to the large savings in costs, for instance, of messengers, security, and other services.

The price of the space in International Square was final, the Director indicated. The staff had checked the price of space in similar buildings in the area: two buildings had been less expensive per square foot, but had been unsatisfactory in other regards, and a number had been more expensive, ranging between $27 and $30 per square foot. The proposed lease would terminate in 1988, and there was a provision that allowed the lease to be extended for five years after 1988. It was difficult to estimate how many additional staff there would be in the following year, but he was sure that the space available would not be sufficient to meet the needs for additional staff.

It was not the role of the staff to decide whether the Fund should move all or some of its operations outside the Washington area, the Director of the Administration Department stated. That question had been discussed a number of times with the World Bank. At present, although the staff was looking at the possibilities of building the Fund's computer center outside Washington, there were a number of problems associated with the issue.

A staff representative from the Administration Department added that the Fund was currently leasing 70,000 square feet at International Square; the total figure would rise to 75,000 square feet with the additional space to be leased. Two complete organizational units were already located at International Square, and the staff proposed that the remaining space should be allocated to small, self-contained units for individuals, for instance, the Legal Advisor.

A second staff representative from the Administration Department explained that the Fund's space standards had been determined early in the history of the institution, and had been compared with standards of the U.S. Government. The physical constraints of the Fund's original building at 1818 H street had also been taken into account, because the columns in the building had dictated where walls could be installed. The Fund had maintained roughly equivalent standards over the years, even when the U.S. Government had cut back its standards with respect to all levels of staff. Executive Directors and Department Heads were allocated 400 square feet of office space. Other senior staff, and Advisors and Alternate Executive Directors were allocated 300 square feet of space. The remaining staff in ranges F-I and Assistants to Executive Directors were allocated 150 square feet of space; secretarial staff and other staff in ranges A-E were allocated space as needed. The largest variable in the space standard was in the secretarial staff area, ranging from 150 to 275 square feet, depending on the type of equipment used.

The figure of $10 per square feet for preparing the space in International Square for Fund occupancy was derived from the cost of completely transforming the space, the staff representative from the Administration Department indicated. A full-fledged renovation of the space at International Square would cost approximately $50 per square foot; the staff had felt that one fifth of that amount would be necessary to use the space in "as is" condition. The major portion of the cost would be taken up in paying for furniture, for moving staff from headquarters, and for telephone service.

The Director of the Administration Department said that the staff considered that the 36 existing surplus offices provided only a limited reserve. The staff would have preferred to keep a reserve of vacant space equivalent to 2 percent of the Fund's total office space, but there was no additional space available at International Square.

The Chairman remarked that it would be convenient to lease office space in International Square; other offices were located there, services could be provided easily, and the price was average. Even though the Fund already had some surplus offices, it would be advisable to take advantage of the leasing opportunity because additional staff would be recruited in the following year. The question of moving all or part of the Fund outside of Washington was in the hands of the Board.

The Executive Board then took the following decision:

The management is authorized to enter into a lease for approximately 5,064 square feet of office space at the International Square building (1875 Eye Street, N.W.) and expend funds not to exceed $10 per square foot, to prepare the space for occupancy as outlined in EBAP/84/129. As in the case of previous leases, the lease may, if necessary, include a waiver of the Fund's immunity from suit on matters arising under the lease.

Adopted June 29, 1984

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/101 (6/29/84) and EBM/84/102 (6/29/84).

4. HUNGARY - EXCHANGE SYSTEM

The Fund notes that Hungary maintains restrictions on payments and transfers for current international transactions as described in EBS/83/268 (12/16/83) and in EBS/84/139 (6/25/84). With respect to the remaining restrictions on import licensing and import quotas introduced in September 1982, in the circumstances of Hungary, the Fund grants approval of these restrictions until August 31, 1984 or the completion of the mid-term review of the stand-by arrangement with Hungary, whichever is the earlier. (EBS/84/139, 6/25/84)

Decision No. 7747-(84/102), adopted
June 29, 1984

APPROVED: March 15, 1985

LEO VAN HOUTVEN
Secretary