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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/126

10:00 a.m., August 31, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
B. de Maulde	A. Le Lorier
A. Donoso	M. Teijeiro
R. D. Erb	J. C. Williams, Temporary
	T. Alhaimus
T. Hirao	T. Yamashita
	J. Reddy, Temporary
R. K. Joyce	M. Casey
A. Kafka	C. Robalino
G. Laske	G. Grosche
G. Lovato	
R. N. Malhotra	
	J. E. Suraisry
	S. El-Khouri, Temporary
J. J. Polak	
	K. G. Morrell
G. Salehkhou	
	E. I. M. Mtei
	S. E. Conrado, Temporary
J. Tvedt	
N. Wicks	C. Taylor
Zhang Z.	

A. Wright, Acting Secretary
J. C. Corr, Assistant

Also Present

African Department: J. B. Zulu, Director; F. d'A. Collings, A. B. Diao, A. C. Woodward. Asian Department: J. T. Boorman, R. J. Hides. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; M. Allen, H. W. Gerhard, S. Kanesa-Thasan, R. L. Sheehy. External Relations Department: H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director; R. D. Kibuka. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila, S. A. Silard. Middle Eastern Department: Z. Iqbal. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Driector; N. M. Kaibni, E. A. Milne, T. K. Morrison. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; M. N. Bhuiyan, D. S. Cutler, D. Gupta, T. Leddy, G. Wittich. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, S. H. Cha, C. M. de Rosa, R. A. Elson, J. Ferrân. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, T. A. Connors, P. Kohnert, H.-S. Lee, Y. Okubo, P. D. Péroz, M. Z. M. Qureshi. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, L. Barbone, R. Bernardo, J. Bulloch, M. B. Chatah, L. E. J. Coene, R. J. J. Costa, M. K. Diallo, M. Eran, G. Ercel, I. Fridriksson, G. Gomel, N. U. Haque, J. M. Jones, A. Juusela, H. Kobayashi, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, G. W. K. Pickering, J. Schuijer, Shao Z., D. I. S. Shaw, P. S. Tjokronegoro, M. Toro.

1. GUATEMALA - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a request from Guatemala for a 16-month stand-by arrangement equivalent to SDR 114.75 million (EBS/83/163, 8/4/83; and Cor. 1, 8/29/83).

The staff representative from the Western Hemisphere Department made the following statement:

> The staff has continued to be in close contact with the Guatemalan authorities since a change in Government took place on August 8, 1983. Both the President of the Bank of Guatemala and the Minister of Finance who signed the letter of intent reproduced in EBS/83/163 have been reconfirmed in their respective posts by the new Government. Furthermore, they have reiterated the commitment of the Government of Guatemala to the policies outlined in that letter, especially in regard to the tax reform introduced on August 1, 1983.

Mr. Conrado made the following statement:

> I would like to express the appreciation of the Guatemalan authorities for the work done by the recent Fund missions in regard to their request for a stand-by arrangement in an amount equivalent to SDR 114.75 million, or 150 percent of Guatemala's quota. As mentioned in the Board's recent discussion of Guatemala at the conclusion of the 1983 Article IV consultation (EBM/83/77 and EBM/83/78, 6/1/83), there was already an agreement in principle between the staff and the authorities on the financial program needed to continue the adjustment effort initiated in 1982. The program which is now being presented to the Board for approval not only reflects that basic agreement, but is also fully in concurrence with Directors' main emphasis and comments made during the Article IV consultation discussion.
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> Given our recent full discussion of developments in the Guatemalan economy during the past few years, there is no need to dwell further on them. Suffice it to say that during the last five years, owing mainly to well-known exogenous factors, the economic and financial situation of Guatemala has continuously deteriorated. The adjustment effort undertaken in 1982, which was supported by a one-year stand-by arrangement in the first credit tranche, while it had some mixed results, was helpful in setting the basis for a more comprehensive stabilization effort such as that now being initiated. In more ways than one, the 1982 adjustment effort underscored the need for further significant action--especially in the fiscal area--and served to galvanize the needed consensus for the approval of the more urgently needed reforms. In this regard, it is important to note that the new Guatemalan Government that recently came into office has kept the same top

economic officials from the previous Administration and has explicitly reiterated the contents of the letter of intent that accompanies the request under discussion. The new Government has also reiterated its commitment to follow without modifications the recently enacted fiscal reform.

The economic program for 1983-84 is well balanced and deserves the Board's support. In general, the program is intended to build on, and strengthen, the adjustment effort initiated last year, especially in the fiscal area, while improving the liquidity position of the Bank of Guatemala. The main objectives of the program are to stabilize the balance of payments position in the medium term, restore the country's access to international capital markets, and establish the basis for export-led sustainable growth in the future. To this end, the program has been structured to obtain equilibrium in the overall balance of payments in the current year, reduce arrears substantially, and bring aggregate demand in line with the depressed supply conditions that have been forced on Guatemala by exogenous forces.

The basic means of achieving the program's objectives is the implementation of a restrictive monetary policy, which is consistent with the achievement of equilibrium in the overall balance of payments in 1983 and a $15 million surplus in 1984. Thus, during the program period the net domestic assets of the banking system are expected to increase at an average annual rate of 6 percent, compared with a rate of more than 30 percent in the previous three years. This rather abrupt reduction in credit expansion is primarily to be brought about by the sterilization of liquidity that has arisen as a consequence of payments arrears accumulated by, mainly, the private sector. As explained in the staff docment, the domestic currency counterpart of the payments arrears accumulated prior to the start of the program will be sterilized through the required acquisition of stabilization bonds in an amount equivalent to 100 percent of requested foreign exchange purchases for arrears cancellations.

However, in great part, the restrictive monetary policy stance will only be made possible by an important adjustment in the fiscal area, which will reduce substantially the budget deficit and its domestic financing requirements. In effect, the centerpiece of the adjustment effort will be the fiscal program, with the overall public sector deficit to be reduced from the equivalent of 5 percent of GDP in 1982, to 3.5 percent of GDP in 1983, and to 3 percent in 1984. This will allow for a reduction in the domestic financing requirement of the public sector, from about 4 percent of GDP in 1982 to 2 percent of GDP in 1983, and to 1.5 percent of GDP in 1984.

During the last two years the main effort of adjustment in the fiscal area has fallen on the side of expenditure. During 1983 it is expected that the overall level of expenditure, both current and capital, will be reduced once again for the second year in succession. During the program period the authorities intend to continue their restraint on expenditure, but will change the focus of adjustment toward the improvement of revenues. This is, indeed, a welcome modification, as Guatemala has one of the lowest tax burdens in the world, and continued cuts in capital expenditure could impair the country's future growth potential. But even more important, the reforms that are being adopted will have a beneficial effect on resource allocation, exports, and the elasticity of the tax system itself. In general, the adoption of the tax reform package has meant a correct and very courageous step on the part of the authorities.

In the area of external policies, the financial program has been designed to allow for a reduction of $50 million in arrears in the second half of 1983 and at least $100 million in 1984. The authorities are well aware of the importance of reducing arrears, and will surely accelerate their reduction if possible. Within the context of the program, however, a more rapid reduction would have implied an even more restrictive monetary policy or a greater amount of foreign financing. Both of these alternatives were not considered feasible in present circumstances.

During our last discussion on the Guatemalan economy, Mr. Senior presented our views regarding the exchange rate policy of this country. There is no need to repeat these views here again. I should only say that the authorities are, of course, aware that the existing parity of the quetzal can only be maintained through financial discipline. The Guatemalan authorities have a long tradition of such discipline.

Mr. Robalino noted that it had been three months since the Board had concluded the 1983 Article IV consultation with Guatemala (EBM/83/78, 6/1/83). At that time, Directors had been aware of the strong influence that political uncertainties in the region had had on production, investment, and capital movements. Guatemala had also faced the withdrawal of foreign lines of credit offered primarily by commercial banks; although the country had been severely affected by the international crisis, the authorities had faced the problems by taking the measures described in EBS/83/163.

Commenting on the program for 1983-84, Mr. Robalino observed that the authorities intended to continue to implement tight fiscal policies to reduce the overall deficit from 5.1 per cent of GDP in 1982 to 3.6 percent in 1983 and 3 percent in 1984. The emphasis given to the curtailment of current expenditures by freezing government salaries and reducing outlays for goods and services, and the decision of the authorities to postpone some investment projects, were measures likely to move the economy in the right direction. On the revenue side, price adjustments were being made in some public services, a policy favorably viewed by the Board at the time of the Article IV consultation. The most important fiscal measure had been the acceleration of the tax reforms.

With regard to monetary policy, Mr. Robalino continued, the authorities planned to maintain a tight policy that, in combination with the tight fiscal policy, could lead a better overall balance of payments position. He welcomed the fact that sound domestic economic policies would result in the reduction in the current account deficit from 4.2 percent of GDP in 1982 to 3.4 percent in 1983 and 3 percent in 1984. He also welcomed the authorities' intention to eliminate the exchange restrictions and to phase the adjustment in interest rates in a flexible way. The combination of policies would result in a change in the rate of growth of real GDP from -3.5 percent in 1982-83 to 1 percent in 1984. The 1983-84 economic program was adequate because it would continue to promote the adjustment process launched by the authorities. Therefore, he could fully support the proposed decisions.

Mr. Teijeiro commented that the deterioration of Guatemala's economy that had begun in 1979 as a result of adverse external developments had been compounded by expansionary domestic policies in 1980 and 1981, leading to the stabilization program implemented in 1982 in conjunction with a stand-by arrangement in the first credit tranche. That program had been said to have produced mixed results because, in spite of a satisfactory performance on the fiscal side and a deceleration in the rate of inflation, the balance of payments objective had not been met, and the loss of net international reserves had been contained only by an intensification of exchange restrictions and the accumulation of arrears.

It would not be fair to attribute to the authorities the entire responsibility for that setback, Mr. Teijeiro considered, because the shortfalls had occurred in areas clearly beyond their control, as a result of the unexpected drop in exports and the shortfall in external financing. The many political uncertainties in the region made the task of restoring internal and external confidence very difficult. Directors should be prepared to adopt a more flexible attitude when judging the relative success of the country's programs, which might require more time and resources than would be necessary under normal circumstances. Experience showed that a quick turnaround in economic performance could not be expected when countries were faced with persistent adverse external developments such as the contraction of world trade and the reduction in foreign credit. For those reasons, he believed that the previous year's program had not been a failure but, rather, an attempt to set the basis for a sustained recovery in the Guatemalan economy, a recovery that would be supported by the present stand-by arrangement with the Fund.

The authorities should be commended for their strong determination to reduce fiscal imbalances, Mr. Teijeiro continued, and they should continue the policy of strict expenditure control together with the implementation of the tax reform. While some public investment might have to be postponed in the short term, the program for the next four years should not suffer major reductions. Therefore, he did not recommend a drastic curtailment of public investment, but a reordering of priorities to put more emphasis on infrastructure projects that would widen the supply base of the economy and, in the medium term, make the balance of payments less critically dependent on certain key imports, such as petroleum.

The withdrawal of private savings that had taken place mainly in 1979 and 1980, and the more recent withdrawal of external credit that had affected the whole region, underscored the need for a sustained increase in public savings, Mr. Teijeiro suggested. There was room for changes in the financing of public works and other investment projects that could be financed by relying increasingly on the World Bank, the Inter-American Development Bank, and other development-oriented institutions. He agreed with the staff recommendations in that regard. The authorities should be commended for their intention to keep the growth of bank credit to a rate consistent with equilibrium in the balance of payments. A sterilization of the domestic counterpart of the payments arrears already accumulated and the realistic interest rate policy to be pursued would certainly contribute to the objectives of the monetary program.

Commenting on external policies, Mr. Teijeiro said that he agreed with the authorities on the need to promote exports outside the region because of the many disruptions that had affected regional trade in recent years. The decision to maintain the existing exchange rate parity with the U.S. dollar seemed consistent both with the adjustment program under way and with the Government's long-run commitment to financial discipline. There was no pressing need to modify the existing parity; if a significant appreciation of the quetzal had taken place, it would have been translated into a serious deterioration in the trade account. However, the main factor in explaining changes in the balance of payments had been the capital account. Furthermore, a devaluation of the quetzal could be counterproductive under present circumstances because it could undermine confidence in the domestic currency and increase the expectation of future depreciations. A country such as Guatemala that had been able to maintain a fixed exchange rate policy over a long period enjoyed a greater degree of domestic wage and price flexibility than others; otherwise, economic difficulties would have become perceptible much earlier. Guatemala suffered a great deal from capital flight, which was clearly related to the political uncertainties that plagued the region. He had no difficulty, therefore, in supporting the recommendation to approve Guatemala's exchange restrictions for the time being. He strongly supported the request for a stand-by arrangement.

Mr. Lovato remarked that there were a number of aspects of the program for Guatemala that caused him concern. Recognizing how difficult the negotiations on the policy package must have been, he believed that the Executive Board should be given some reassurance with regard to the intention of the new authorities to adhere to the commitments agreed upon by the previous Government. In that regard, he welcomed the information provided by the staff at the beginning of the meeting that the new authorities had committed themselves to the letter of intent of their predecessors.

The program involved the use of Fund resources at an annual rate of 112.5 percent of quota, Mr. Lovato noted, and the arrangement was limited to 14 months. The considerable Fund support would lead to an improvement in the current account of only 0.2 percentage points between 1983 and 1984, although it would lead to approximate equilibrium in the balance of payments. In the section of the staff paper dealing with the medium-term outlook, the staff appeared to consider a deficit of that size more or less financeable. However, the adjustment was extremely small. Were the staff or management confident that past practice and the recently discussed guidelines for the determination of the extent of Fund support had been adhered to?

It was not surprising that the improvement in the current account was going to be relatively small, Mr. Lovato considered, given the way in which the program had been formulated. The arguments accepted by the staff for the maintenance of the one-to-one peg to the U.S. dollar were somewhat perplexing. The information in Chart I of EBS/83/163 indicated clearly that the quetzal had appreciated more than at any time since 1970; not surprisingly, exports had been falling, and, according to the staff's projections, the 1981 level was not to be reached again before 1986 at the earliest. Consequently, the moderate improvement in the trade balance leading to the almost negligible improvement in the current account was once again to be achieved through import compression and a reduction in the level of activity, rather than through an expansion of the export base and of exports. The authorities appeared to be aware of the problem of profitability, and they claimed that the introduction of a value-added tax would make it impossible to provide an added incentive through tax rebates. While he could follow that argument, a more logical policy would have been to adopt a more realistic exchange rate to restore reasonable competitiveness.

Commenting on the fiscal aspects of the program, Mr. Lovato said that he agreed with the staff that the tax reform would constitute a simplification and an improvement of the current system. Tax reform was absolutely necessary, not only because it was the only substantial policy change proposed, but also because even the moderate improvement in the current account might otherwise be jeopardized. As for expenditures, the compression would be felt particularly on the capital side; he would have preferred to see the authorities decide to cut more deeply into current expenditures. The pace of reduction of external arrears appeared extremely slow. Did the staff have any indication as to the acceptability among foreign creditors of the stabilization bonds issued by the Guatemalan Government? To make matters worse, the restrictive exchange measures put in place recently were not expected to be reversed in the foreseeable future.

The arguments that he had put forward led him to conclude that the program under consideration envisaged very little adjustment effort, that it did not have ambitious targets with regard to the external accounts, and that its implementation would be uncertain, Mr. Lovato stated. However, despite his many doubts and reservations, he could go along with the views of the majority of Directors and support the proposed decisions.

Mr. Grosche said that he too could support the proposed decisions. His support rested on the assurance by Mr. Conrado that the Government was prepared to honor the terms of the understanding with the Fund. According to press reports, the Government appeared to be less determined than its predecessor to implement the required adjustment measures. The reports suggested that the authorities were considering a reduction in the rate of the recently enacted value-added tax or even its abolition. If those ideas were translated into actions, the core of the stand-by program before the Board would have been seriously affected. Following Mr. Conrado's assurance that the Government had reiterated its commitment to follow the recently enacted fiscal reform without modifications, he could support the program, although it could not be considered a very ambitious one, with regard to either fiscal policy or balance of payments policy.

Guatemala's efforts to reduce the overall public sector deficit by restraining expenditure and by raising tax revenues were welcome, Mr. Grosche continued. The attempt to improve the tax collection system and to introduce new taxes was expected to increase government revenues. However, it was disappointing that the share of central government revenue in GNP would decline between 1982 and 1983 by 0.2 percentage points, although the new measures would contribute revenues of 0.5 percentage points of GDP. In 1983 the bulk of the adjustment effort again had to rely on expenditure restraint. Although the new tax measures would be fully effective in 1984, the ratio of total revenue to GDP would still be below that of 1980. There might exist further scope for raising taxes.

The improvement in the overall budget deficit was not expected to provide a basis for a marked improvement in the current account, Mr. Grosche observed. A major adjustment in the current account had taken place in 1982, and less was expected in 1983. But in 1984, when the program under the stand-by arrangement should be fully operative, the deficit was projected to remain virtually unchanged at about 3 percent of GDP. Furthermore, it did not appear that the foreign exchange shortage would be overcome by the end of the program. According to the staff's projections, gross reserves, defined in terms of months of imports, would actually decline in the coming years.

It had been rather puzzling, therefore, that the exchange rate had not been considered an instrument of adjustment, Mr. Grosche commented. The staff appeared to agree with the authorities in that regard, although it stressed that the decision underscored the critical need to pursue restrictive demand management policies. The staff had taken the position that the real appreciation of the quetzal in recent years just compensated for a real depreciation that had occurred earlier. However, he agreed with Mr. Lovato that the information in Chart 1 of EBS/83/163 did not support such a view. Over the years, the quetzal had clearly appreciated. The conventional wisdom was that purchasing power parity calculations were only one of a number of indicators that provided a guideline to the design of exchange rate policies. A more reliable guideline appeared to be the position of the balance of payments itself. Indeed, given the worrisome projections for exports, a change in the peg to the U.S. dollar did not appear inappropriate. He invited the staff to comment further on the matter.

The authorities should be commended for their intention to reduce external payments arrears as soon as possible, Mr. Grosche added. Success in that field would be remarkable since the difficulties imposed by the tight foreign exchange situation were likely to continue. Finally, support of the program implied granting the Government the benefit of the doubt. It would have to face up to the challenges implicit in the program, which would have to be thoroughly examined at the time of the review in 1984.

Mr. Casey said that he welcomed the authorities' resolve to continue with the economic adjustment program initiated in 1982. Some progress had been achieved to date, primarily in slowing inflation and reducing the public sector deficit as a percentage of GDP. He agreed with the general thrust of policies outlined in EBS/83/163; they should result in strengthening Guatemala's fiscal position as well as in restoring a sustainable balance of payments position in due course. However, those policies would have to be pursued with determination, given the Government's reluctance to change the exchange rate and the expected significant rise in debt service payments over the next few years. The debt service ratio would reach 31 percent in 1985, about four times the ratio in 1982.

The tax reforms were welcome, even if overdue, Mr. Casey continued. The substitution of the value-added tax for the existing sales tax should improve the efficiency of the overall tax system and generate needed revenues. However, the coverage of the value-added tax should be widened over time. A number of expenditure categories were exempt from the value-added tax at present, and he agreed with Mr. Grosche that there was a need to increase the scope of revenue raising measures in general. The freeze on government salaries should serve to limit the increase in current expenditures, although it appeared, strangely enough, that an 11 percent wage increase was budgeted for 1984, which did not appear to be a freeze. Could the staff provide further information on that point? The decision to reduce public investment in order not to overstretch the country's financial capacity was welcome; he hoped that priority investment projects would not have to be curtailed unduly.

Turning to monetary policy, Mr. Casey commented that the plan to reduce the growth of overall bank credit to a rate consistent with equilibrium in the overall balance of payments would need to be closely adhered to. He was not convinced that the present interest rate ceilings allowed sufficient flexibility for the interest rate to adjust to changing conditions; in the past, the authorities appeared to have been hesitant to change the interest rate ceilings. Increased interest rates on deposits might well lead to increased financial savings and help to keep those savings in the country. He welcomed the authorities' intention to follow a more flexible interest rate policy and encouraged them to proceed rapidly in that direction.

The reduction of payments arrears was necessary if the confidence of international lenders was to be strengthened, Mr. Casey suggested. In that regard, the expected increase in foreign borrowing by the public sector was a matter of concern, as were the moves to assume private sector external debts through the issuance of stabilization bonds. The takeover of private sector debts by the Government had inherent dangers, and he invited the staff or Mr. Conrado to say how the authorities would ensure that adequate foreign exchange could be obtained to cover the obligations associated with the stabilization bonds. Did the Government have a timetable for the ultimate elimination of that mechanism? It was open to question whether the authorities' intention to maintain the existing parity of the quetzal to the U.S. dollar was appropriate, as the real effective exchange rate was at present very high. It could be argued that fears of a devaluation in 1982, rather than political uncertainties, had been the significant factor contributing to speculative outflows.

The program was reasonably appropriate, Mr. Casey considered, but it could have been improved. For example, greater fiscal adjustment through a broader-based value-added tax would have done more to close the fiscal deficit, lessening the need to borrow abroad, and thereby reducing the increase in the debt service ratio. A greater fiscal adjustment would also have helped to accelerate the improvement in the current external deficit, thus facilitating a faster payment of external arrears, an important objective for reasons of confidence. Given that an "extra" degree of adjustment was not being taken, the exchange rate link to the dollar might not hold much longer. It could be argued that the imposition of payments restrictions in the past had been a proxy for a devaluation, and that, as those restrictions were removed, which he hoped would occur rapidly, the exchange rate was likely to come under pressure. Indeed, the new tax credits on nontraditional exports outside the Central American Common Market could also be regarded as a proxy for a devaluation. He assumed that the Government would implement the program fully; in that regard, the review would be important.

Mr. Taylor stated that he welcomed the objective of achieving an overall balance of payments equilibrium in 1983 and a small overall surplus in 1984. If the authorities persisted with their efforts, there was ground for hoping that the economy could resume the rate of growth that it had experienced in the 1970s. The economic policies envisaged under the program for 1983 and 1984 appeared mainly sound, although he agreed with those Directors who had suggested that action on the exchange rate would have been a means of taking some of the burden of adjustment from domestic policies. In fact, the pace of adjustment on the external side appeared modest.

The authorities' intention to lower the public sector deficit from 3.6 percent of GDP in 1983 to 3 percent in 1984 was certainly a movement in the right direction, Mr. Taylor continued, although a more substantial improvement would have been even more welcome. Success in that area would depend to a large extent on the effectiveness of the tax reform measures recently introduced in reducing the past high levels of tax evasion. He hoped that the authorities would persist in their efforts to build up revenue yields; as a slightly longer-term objective, there might be scope for lessening the existing heavy reliance on indirect taxation. Had the authorities considered the possibility of increasing taxes on incomes or property? In present circumstances, the introduction of a more extensive income tax system might be difficult, but it would be interesting if the staff or Mr. Conrado could comment on the likely direction that the authorities would take in due course. The intention to reduce the overall level of current expenditure in 1983 was also commendable; much would depend on whether the 1982 freeze on government salaries could be sustained. He noted the point that Mr. Casey had made in that regard. Wage restraint in the public sector could not be taken for granted because wage increases had taken place in the private sector in 1983, albeit relatively moderate ones. Given the doubts that had been expressed in that area, had the staff considered the possible consequences of higher wages and salaries in the public sector for the fiscal position, and what might be done to compensate for them?

The authorities should also be commended for their intention to restrain capital expenditure, Mr. Taylor suggested. They had already revised the overall public investment program, but the staff had referred in detail to plans to establish public investment priorities over the next two or three years; a recent World Bank report on Guatemala had suggested that external technical assistance might be necessary to strengthen the public sector's capacity to identify and evaluate investment projects in terms of their contribution to future GDP growth, particularly in the relatively underdeveloped highland regions. Could the staff provide further information in that area? The authorities' intention to keep the financial position of the decentralized agencies and the state enterprises in overall balance or in surplus was welcome, together with the more realistic tariffs introduced in the electricity and the telecommunications sectors. The importance of keeping the rates charged by all the public enterprises under close review in the coming months could not be overemphasized.

Monetary policy was a fairly strong feature of the program, Mr. Taylor considered. The authorities' intention to reduce sharply the growth of net domestic assets from the banking system to an annual rate of 6 percent by lowering the public sector's demand for credit while issuing stabilization bonds to finance the clearance of payments arrears, was welcome. He agreed with the staff and with other Directors that a more flexible approach toward interest rate policy would be required.

The projected modest decline in the current account deficit from 4 percent of GDP in 1982 to 3 percent in 1983 was to be achieved largely through an improvement in the trade balance, Mr. Taylor observed, an approach that seemed entirely appropriate. But the improvement relied heavily on further cuts in imports, raising the question whether the strategy, if sustained, would adversely affect the economy's growth potential. In future, it would be important to pay greater attention to export performance, and to the diversification of exports to nontraditional markets. He invited the staff and Mr. Conrado to provide more detailed information on the authorities' plans in that field. Was the necessary technical and marketing expertise available in Guatemala to help firms that had been currently selling in regional markets to tackle markets outside the region?

If there was a gap in the adjustment program proposed by the authorities, it was the absence of an exchange rate policy, Mr. Taylor added. He recalled that during the Executive Board's discussion in the course of the Article IV consultation a few months earlier, his chair, among others, had questioned the appropriateness of the traditional exchange rate policy. He shared the doubts expressed by other Directors in the present discussion. The decline in export earnings, together with the persistence of the parallel exchange market, suggested that exchange rate policies should be looked at again with a view to improving external competitiveness. He welcomed the Government's intention to eliminate exchange restrictions during the period of the arrangement and to begin an orderly procedure for the cancellation of payments arrears.

Any significant increase in external borrowing would affect the debt service ratio, Mr. Taylor continued, which was projected to rise substantially in the medium term to above 30 percent in 1985. There appeared to be a link between the projected path of that ratio and the path of GDP, which was expected to rise at an annual rate of 5 percent by the late 1980s. The link suggested that the structure of the program depended heavily on the assumptions that had been made about recovery in the rates of economic growth, and it was open to question whether the projected growth rate was in fact sustainable. Gross reserves expressed in terms of months of imports were projected to fall by more than 40 percent in the coming five years, reinforcing the belief that a stronger stabilization effort, or at least a continuation of existing efforts after the conclusion of the present stand-by arrangement, might be necessary to achieve a sustainable balance of payments and reserve position. If a follow-on arrangement were considered, he hoped that it would be designed carefully in light of the medium-term outlook.

Mr. Williams recalled that at the time of the 1983 Article IV consultation (EBM/83/78, 6/1/83), Directors had examined the broad outlines of the adjustment program that the Guatemalan authorities intended to pursue in FY 1983/84. The proposed program was consistent with the views expressed by Directors. Both fiscal and monetary policies were appropriate to the adjustment objectives. It was critical for the success of the program that the authorities should remain committed to the comprehensive tax reforms that had been recently introduced. Given the economic uncertainties, perseverance would be required if the revenue targets in the program were to be attained. He invited the staff to provide any updated information that it might have on fiscal developments.

His authorities were concerned about the stabilization bonds being issued in connection with unsatisfied claims by residents for foreign exchange, Mr. Williams stated. While he could support the objective of sterilizing the domestic currency counterpart of payments arrears, it was disturbing that some foreign suppliers or creditors might feel pressured to accept the bonds in settlement of obligations due to them. Although it might not be the intention of either the authorities or the staff, the policy was thought by his authorities to represent a real risk. If allowed to persist, such a perception would be detrimental to re-establishing Guatemala's international credit rating. He invited the staff to comment on the subject.

Discussing external sector policies, Mr. Williams said that he could support the basic thrust of Guatemala's exchange rate policy, which emphasized the importance of pursuing domestic policies, particularly monetary policy, conducive to stable exchange rates. However, as other Directors had noted, circumstances could arise periodically in which a change in the real effective exchange rate was the best means of promoting an adjustment in the current account. Such a change in Guatemala's exchange rate might be appropriate at present. The explicit timetable for the elimination of external arrears was welcome, but it would have been preferable if the objective could have been achieved more rapidly. He also welcomed the intention to eliminate exchange restrictions during the period of the arrangement.

Mr. Morrell remarked that Guatemala's economic difficulties and large external financial imbalances had been due to a combination of exogenous developments, particularly depressed prices and demand for exports, aggravated by uncharacteristically expansionary fiscal and monetary policies. Political disturbances in the region and speculative factors affecting the capital account had made the adjustment all the more complicated. If the assumptions in the program for 1983 and 1984 remained valid, the measures were adequate to meet the program's objectives, although they could be strengthened in a number of areas.

The fiscal measures aimed at reducing the overall fiscal deficit from 5 percent of GDP in 1982 to 3 percent in 1984 were particularly welcome, Mr. Morrell continued. The introduction of the value-added tax was notable, although it could have been wider in application. The merits of a value-added tax system were well documented in the economic literature; however, its use in developing countries had been rather limited. It would be interesting to reflect upon Guatemala's experience in due course as an indication of the effectiveness of such a system in a developing country. The measures to slow the growth in overall domestic bank credit were also appropriate, particularly the intention to sterilize the domestic currency counterpart of the payments arrears accumulated before the start of the program. He noted the points made by Mr. Williams.

Acknowledging the reservations of a number of Directors, Mr. Morrell said that he agreed with the authorities' decision to maintain the existing parity of the quetzal to the U.S. dollar, provided that they pursued tight demand management in line with their long tradition of financial discipline. However, if significant overvaluation of the currency should occur, the authorities should review their policy in light of the need to maintain export competitiveness with countries in the region.

Interest rate policy was a matter for concern, as other Directors had mentioned, Mr. Morrell concluded. The ceilings on domestic interest rates had been lowered in 1982, and the staff mentioned that that policy would be reviewed during the program period. Such a review should consider the effectiveness of a liberalization of interest rates as a means of increasing domestic savings and as a disincentive to further capital flight. The debt service ratio was projected to increase from 8.5 percent in 1982 to 31 percent in 1985, owing to the combined influence of various factors, including large repurchase obligations to the Fund, and was projected to subsequently fall to about 17 percent in 1988. He wondered whether consideration had been given to smoothing out the bulge in debt service payments.

Mr. El-Khouri noted that in recent years Guatemala's balance of payments had come under pressure owing to both adverse external developments and expansionary domestic financial policies. The stabilization program, in support of which the authorities were requesting a stand-by arrangement with the Fund, represented an appropriate response to the present financial difficulties. In the area of fiscal policy, the program aimed at a gradual reduction of the public sector deficit from 5.1 percent of GDP in 1982 to 3 percent in 1984. The reduction was to be achieved through a strengthening of the finances both of the Central Government and of the state enterprises. As far as the Central Government was concerned, the ratio of revenues to GDP had been declining in recent years. The recent decision to enact a major reform of the tax system with the aim of enhancing government revenues was, therefore, welcome. The tax reform was also aimed at increasing incentives for production and exports, which should provide additional support to the balance of payments, assuming that there was the necessary flexibility in resource mobilization and that export markets were available. The fiscal adjustment process also involved a reduction of the public sector investment program. The staff noted that that reduction would involve the cancellation or postponement of many projects; however, the staff had not discussed the likely effects of the reduction in real capital expenditures on growth prospects over the medium term. Perhaps the staff could provide further information on that point and on the World Bank's evaluation of Guatemala's public sector investment policy.

The authorities' intention to reduce external arrears during the program period was welcome, Mr. El-Khouri continued. Such a reduction was essential if the confidence of Guatemala's foreign creditors was to be restored. He also supported the limits specified in the program on the increase in Guatemala's external indebtedness. Why had the limits been established on contracted debt while in some recent Fund-supported programs the limits had been established on disbursed debt? What was the basis for choosing one criterion rather than the other? The staff mentioned that the authorities intended to increase public sector borrowing from multilateral lending agencies to finance ongoing investment programs, but it had given no details on such borrowing, and the information in Appendix 3 of EBS/83/163 indicated that IBRD/IDA disbursements were projected to fall considerably in FY 1983/84. He invited the staff to comment further on the question.

Guatemala's decision to maintain the existing parity of its currency to the U.S. dollar was understandable in view of the explanations given by the staff and Mr. Conrado, Mr. El-Khouri considered. However, exchange rate policy should be closely watched, particularly if the projected improvement in the balance of payments failed to materialize.

Mr. Malhotra said that he agreed with the staff's appraisal and could support the proposed decisions.

The staff representative from the Western Hemisphere Department commented that the program had been designed in such a way that Guatemala could draw 50 percent of its quota in three succeeding six-month periods; thus, in 1984, the use of Fund resources would be exactly 100 percent of quota. The annual rate in the remainder of 1983 would be slightly higher, reflecting the fact that the main policy measures under the program had already been in place by the middle of the year. Indeed, there had already been a substantial adjustment domestically through reductions in the fiscal deficit and in domestic financing requirements. The overall deficit of the public sector had declined from 7 percent of GDP in 1981 and would be about 3 percent of GDP in 1984. In that sense, the program was a continuation of efforts to consolidate adjustment.

While the changes in the tax system represented a major reform, the staff representative continued, he could agree with those Directors who had suggested that the system could be improved further through a broadening of the coverage of the value-added tax. A significant adjustment had been made in current expenditures in that there had been a reduction in nominal terms in the previous two years. Wages and salaries had been frozen in FY 1982 and FY 1983, and some adjustment was expected in the coming fiscal year, given the real deterioration that had taken place over the previous two years. Whether an 11 percent increase would in fact be granted, as one Director had suggested, would be decided later in 1983.

The current account deficit was not inordinately large in relation to the resources that the authorities could mobilize to finance it, the staff representative considered. Guatemala had suffered from a liquidity squeeze that had created problems in the balance of payments, particularly in the capital account. The outflow of private capital had had an adverse effect on the balance of payments. The program was an attempt to create the conditions that would lead to a restoration of external financing while keeping the current account deficit within the authorities' financing capabilities. The debt service ratio was projected to increase substantially during the program period, reflecting in large part the repayment of external arrears. It was arguable that from the point of view of the economy as a whole, the debt service ratio would not change dramatically, because the Government would, in effect, be absorbing a certain amount of the debt burden of the private sector. Insofar as that development took place, the increase in the debt service ratio could be regarded as moderate.

Commenting on the gross reserves ratio, the staff representative observed that the ratio of reserves to imports had declined. However, the quality of those reserves was expected to improve because the composition was expected to change dramatically. At present, the effective reserves of the Bank of Guatemala were lower than the figures used in the staff report, because a significant component of those assets reflected non-liquid claims on others members of the Central American Common Market. As the program developed and the medium-term outlook improved, it could be assumed that the quality of gross reserves would change through an increase in the share of truly liquid reserves and disposable foreign exchange.

The reduction in arrears projected in the program was a minimum target, reflecting cash payments, the staff representative stated. To the extent that arrears were rescheduled through the acceptance of stabilization bonds, a larger reduction would effectively take place, although it was not expected that foreign creditors would accept a significant quantity of the bonds. The arrears represented the assumption of private debt in the sense that they were payments for obligations arising out of imports that the private sector would normally have paid, but the authorities intended to be assured that the arrears were for obligations past due that would have been paid if foreign exchange had been available. The bonds did not represent an assumption of future debt obligations of the private sector. Nor did the authorities wish the issuance of the bonds to be regarded in any way as an attempt at unilateral rescheduling. The bonds would have to be voluntarily accepted by foreign creditors, and clear documentation would have to be provided to the Bank of Guatemala to indicate that the arrangement had been negotiated between private importers and foreign creditors.

The staff believed that there were valid arguments on both sides of the issue of exchange rate policy and the maintenance of parity to the U.S. dollar, the staff representative went on. In the end, it had come down on the side of those, including the authorities, who believed that the program could remain viable while the existing parity was maintained. One factor in that assessment was the long tradition of financial discipline in Guatemala, and the authorities' clear intention to return to sound and restrained financial policies. There also appeared to be a willingness on the part of the Guatemalan authorities to use more deflationary policies than other countries might be willing to use, as reflected in their public expenditure policy. Furthermore, the staff did not believe that, on the basis of indicators of the real effective exchange rate, it could be said that the quetzal was significantly overvalued. However, the staff agreed with the Directors' comments that the policy should be kept under continuous review and that, if the quetzal appreciated substantially, a policy choice would have to be made.

The effectiveness of a devaluation in boosting Guatemala's exports might not be large, the staff representative added. The authorities believed that recent export performance had been affected as much by conditions in external markets as by domestic factors. Many of Guatemala's exports were affected by international or national quotas that were the determining factors in export volume. The political and economic crisis in Central America was another nonprice factor affecting Guatemala's traditional industrial exports. Finally, some of the fiscal measures included in the tax reform could be regarded as substitutes for an exchange rate change, such as the way in which the value-added tax affected exports, the reduction of the tax on the export of traditional commodities, and the limited use of tax credit certificates for nontraditional exports.

The World Bank had provided technical assistance for the public sector investment program, the staff representative from the Western Hemisphere Department remarked, and the program was being reviewed by the Bank at present. It would also be reviewed in the context of the regional consultative group established by the Inter-American Development Bank. The program reflected a shift of emphasis away from the large infrastructure projects in the hydroelectric field following the revaluation of planning procedures that had taken place in 1982, which had led to a decision to postpone future projects in that field not considered strictly necessary, or involving large amounts of external borrowing. There would be a greater emphasis on social sectors such as health and education; nevertheless, about 40 percent of planned investment in the coming five years would be in electrification and other infrastructure development, such as roadbuilding and telecommunications. With regard to the question of technical assistance for the promotion of exports outside Central America, the World Bank and the Inter-American Development Bank were expected to approve credit facilities soon for that purpose. Export promotion efforts were also being supported by a government agency with the help of external technical assistance.

The Deputy Director of the Exchange and Trade Relations Department noted that one Director had asked whether the extent of the adjustment in the balance of payments was consistent with Fund practice. The program's objectives included equilibrium in the overall balance of payments in 1983 and a small surplus in 1984. A faster rate of adjustment would probably involve a faster rate of repayment of external payments arrears. The arrears were being reduced, although it might be argued that they were not being reduced quickly enough. The staff had looked carefully at the way in which the external debt service structure was influenced by the pattern of the repayments of arrears and was confident that the repurchases of outstanding Fund credit would proceed as expected. The extent of the adjustment was, therefore, consistent with the revolving use of the Fund's resources.

With regard to the use of stabilization bonds, the Deputy Director of the Exchange and Trade Relations Department remarked, the staff believed that there were advantages in such a procedure because it allowed arrears to be registered and to be dealt with in an orderly way. The approach was not dissimilar from that followed in other Fund programs in which the member had been asked to set up a counterpart scheme at the central bank so that the arrears could be paid off gradually.

Mr. Conrado stated that the financial program adopted by the authorities was well balanced and appropriate to the current circumstances of Guatemala. Moreover, the fiscal reform that was the centerpiece of the adjustment effort was already in effect, and the Government had reiterated its commitment to continue it without significant modifications. The monetary program had already been approved by the Monetary Board and was being implemented in a manner fully consistent with the requirements of the stand-by arrangement. Economic management was not easy in Central America's current circumstances. A drastic turnaround in economic conditions and activity could not be expected from one year to the next. Adjustment was a process that would take time and perseverance with sound policies. Guatemala had traditionally followed such sound policies and could be expected to persevere with its present efforts. He emphasized that the stand-by arrangement broadened and strengthened the stabilization effort initiated in 1982.

Guatemala had traditionally kept fiscal deficits relatively low, Mr. Conrado continued. The country had one of the lowest tax burdens in the world, so that the low deficits had been achieved through the maintenance of low levels of expenditures. Fiscal restraint in the previous two years had been maintained mainly through cuts in expenditure. The present program, therefore, implied a significant departure in the sense that it had changed the focus toward revenue improvement. But it had not been easy. Taxes were a sensitive issue in Guatemala, much more so than in most countries. The present fiscal reform was clearly a first step in the right direction, but more needed to be done. The authorities would, however, have to move carefully, and Directors could not expect drastic changes in the near future.

At the time of the 1983 Article IV consultation, Mr. Conrado recalled, Mr. Senior had presented at length the authorities' views on exchange rate policy. The authorities were not fully convinced that a change in the parity of the quetzal or the fixed peg to the U.S. dollar was needed, at least at present. The exchange rate had to be viewed as one of an array of instruments at the disposal of the authorities. Given the deterioration of economic activity and employment that Guatemala had suffered during the previous four years, it should not be surprising that the authorities were understandably concerned to ensure that adjustment would rest principally on policy instruments that did not unduly affect output and employment adversely. In other words, they wished to be especially selective regarding policy instruments in order to minimize the cost of adjustment and not to exacerbate inflationary pressures and labor market instability. Only in such a context could fiscal discipline be maintained and the success of the program assured.

There also appeared to be no conclusive evidence that Guatemala's traditional and nontraditional exports had suffered substantially from a loss in competitiveness, Mr. Conrado suggested. Exports had been affected primarily by exogenous factors, such as the introduction of quotas for the main export products or declines in international prices. As to traditional exports, the area under plantation and the volume of production for commodities such as coffee, sugarcane, and bananas, had remained stable or increased. It was true that the amount of cotton grown on plantations had fallen substantially, but cotton exports had usually been sensitive to political circumstances in the region, and exports of cotton from Nicaragua and El Salvador had also fallen substantially. The significant fall in Guatemala's nontraditional exports to other Central American countries could be explained by the depressed level of economic activity in the region, and particularly by the payments difficulties that the Central American countries were facing at the moment. Thus, price was not a factor causing nontraditional exports to fall, and the authorities were not convinced that the exchange rate had resulted in a loss of competitiveness.

The stabilization bonds had been introduced mainly as a means of determining the actual amount of arrears, Mr. Conrado said. It was not the authorities' intention to force them on creditors in any way. Creditors could, of course, accept them voluntarily, but he did not believe that many such bonds would be used for such a purpose. In any case, they would be redeemed as soon as the foreign exchange was available to importers to pay the creditors. Finally, real interest rates in Guatemala were positive, and inflation, depending on how it was measured, was low at present. However, the authorities were willing to continue a flexible interest rate policy and to adjust rates if necessary.

The Executive Directors then took the following decisions:

Stand-By Arrangement

1. The Government of Guatemala has requested a stand-by arrangement for the period August 31, 1983-December 31, 1984, for an amount equivalent to SDR 114.75 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/163, Supplement 1.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7507-(83/126), adopted
August 31, 1983

Approval of Exchange Restrictions

The Fund grants approval for the retention by Guatemala of the restrictions on payments and transfers described in EBS/83/163 until May 31, 1984, or the time of the mid-term review of the stand-by arrangement, whichever is earlier.

Decision No. 7508-(83/126), adopted August 31, 1983

2. REVIEW OF POLICY ON ACCESS TO FUND RESOURCES

The Executive Directors considered a staff paper on the scale of, and the limits on, enlarged access to the Fund's resources (EBS/83/172, 8/12/83), a paper on legal and policy considerations related to access to the Fund's resources (SM/83/194, 8/19/83), and a paper on the application of the requirement of cooperation under the compensatory financing facility (EBS/83/171, 8/12/83). They also had before them a paper reviewing the guidelines for borrowing by the Fund (EBS/83/187, 8/26/83), and a copy of the Chairman's remarks concluding the discussion on the review of access to the Fund's resources at EBM/83/110 and EBM/83/111 (7/25/83) (Buff Document 83/210, 8/1/83).

The Chairman made the following statement:

I suggest that the material before Directors, together with the earlier papers on access and liquidity, provides the basis for an active and productive discussion of the issues to be included in your report to the Interim Committee on review of policy on access to Fund resources. The draft report will be discussed on Wednesday, September 7, and it is expected that today's discussion will provide considerable guidance to the staff in preparing this draft.

Without seeking in any way to prejudge the results of today's discussion, it may be helpful to outline the several issues that need to be covered.

1. Enlarged access limits. The views of three groups of Directors on enlarged access limits were summarized in Buff Document 83/210. I hope that it will be possible to make further progress in narrowing the divergence of views and therefore encourage Directors to return to this key issue in their remarks. As one approach to resolving differences on the maximum annual limit, it was suggested that we consider a two-tier approach. The staff has examined alternative possibilities (EBS/83/172), and we would welcome your reactions, including views regarding the staff suggestion at the top of page 4 of the paper.

2. Maintenance of enlarged access limits in absolute terms. Some Directors asked for a staff paper on the legal and other aspects of a grandfather clause (Section II of SM/83/194). Only a few Directors spoke on this topic on July 25, and to the extent that such a policy would be consistent with the principle of uniformity of treatment it would appear to have been covered adequately by the form of the two-tier approach suggested by the staff and could be discussed in that context.

3. Phasedown of enlarged access limits. On July 25, Directors broadly agreed that it would be premature to decide on either a timetable or amounts for the phasedown of enlarged access limits. It is my understanding that Directors preferred to provide for periodic reviews of these limits, perhaps yearly, in the light of relevant considerations in order to determine an appropriate form of phasing down.

4. Reduction in the amount of existing stand-by and extended arrangements. The staff was asked to examine the legal and policy aspects of this proposition (Section III of SM/83/194), and comments by Directors are invited.

5. Scale of enlarged access. On July 25, we had a fruitful discussion of the considerations governing the extent of access in individual circumstances, and the staff was asked to prepare a note describing the considerations governing the extent of access (pages 1-3 of EBS/83/172). If there were a consensus along the lines of the description presented in the staff paper, one possibility would be to include this description of the Board's policies as an annex to your report.

6. Form of access limits (total, conditional, special). In the July 25 discussion, Executive Directors generally did not support a comprehensive limit on total access, and therefore it is assumed that this possibility need not be mentioned in the draft report. My understanding is that, quite apart from the numbers themselves, there is a consensus that for the conditional facilities there is a need to reach agreement on a maximum annual limit and a cumulative limit (net of repurchases scheduled at the time of approval of the arrangement). Similarly, it appears that there is little disposition to change the existing form of limits for the special facilities.

7. Special facilities - access limits. In the discussion on July 25, those speakers who supported maintenance of the 150 percent annual limit for enlarged access also favored retention of the present quota limits for the special facilities. Other speakers were in favor of a reduction in the access limits for both consitional and special facilities. Some speakers in the latter group would like to see the access limits on special facilities reduced more than in proportion to any reduction of quota

limits under the enlarged access policy. As in the enlarged access limits, it will be important in today's discussion to try to narrow these differences for presentation to the Interim Committee.

8. Special facilities - requirements of cooperation. After preliminary discussions of this topic, during which a range of views was expressed, the staff has prepared a brief paper describing policies on the requirement of cooperation to purchases in the lower and upper tranches of the compensatory financing facility (EBS/83/171).

9. Finally, the report of the Executive Board will need to cover the means of financing the new enlarged access policy, including the need for continued borrowing by the Fund after the quota increases. The report would also need to reflect the intentions of the Executive Board to simplify the procedures, including the "mixing" ratios, under which the use of ordinary and borrowed resources are determined in connection with enlarged access (see Section V of EBS/83/133).

Mr. Polak commented that there were really two separate subjects before the Board: the policy on access and the requirement of cooperation under the compensatory financing facility. It would be preferable if Directors could address the subjects separately.

Mr. de Maulde remarked that the question of financing, point 9 in the Chairman's statement, was a complex issue that would merit a separate discussion. It might not be possible to cover both that subject and the general question of access policy at the present meeting.

Mr. Wicks said that he agreed with Mr. de Maulde that the question of financing deserved an in-depth discussion. However, it was such an important aspect of the problem that it could not be wholly ignored when the enlarged access policy was discussed.

The Chairman commented that he understood Mr. de Maulde to mean that the technical aspects of financing, such as the mixing ratios, need not be discussed at the present meeting. It seemed appropriate to proceed in that manner.

Some Directors had wondered whether the staff had changed its views on the two-tier approach to enlarged access, the Chairman continued, because of the way in which the passage at the top of page 4 of EBS/83/172 had been drafted. However, the staff's position had not changed, as was explained later on page 4. Its preference was for a system of limits of 125/375/500 with the possibility of exceeding the annual and triennial limits in exceptional circumstances, subject to the cumulative access limits of 500 percent of quota.

Introducing more precision into the criteria governing the use of access and the scale of access attached to individual programs, as a number of Directors wished, was important, the Chairman stated. However, it would also be important to retain a degree of flexibility for management; some circumstances could call for judgments that might not be completely captured by a set of criteria. For example, with regard to the highly interesting two-tier proposal put forward by Mr. Wicks, management should have leeway in applying the criteria governing the 102 percent and the 125 percent limits. Mr. Wicks's proposal was consistent with the type of flexibility that he had in mind, if drafted appropriately.

Executive Directors should bear in mind that the Board would also retain the option of exceeding the normal limits in exceptional unforeseen cases, the Chairman added. It would also be important to maintain the integrity of the Fund's stand-by arrangements, particularly in light of relations with commercial banks. The complex financial packages that the Fund arranged in conjunction with commercial banks would be much more difficult to complete if the Fund's resources available to the member could be reduced in a way that had not been determined when the arrangement had been put in place. Such a possibility would create a good deal of uncertainty for the member and would complicate the task of cooperation with the commercial banks.

Mr. Kafka noted that the question of access had to be discussed in preparation for the forthcoming meeting of the Interim Committee. He hoped that the discussion would encourage Directors to reflect on the alarming implications of some recent statements in the Board, by which speakers appeared to seek to reduce access beyond any need that might be imposed by the limitation of the resources available to the Fund. After all, the amount of available resources was not known; the Chairman might well be successful in his efforts to obtain additional resources, and he might be able to supplement those resources at a later date. Leaving aside, for the moment, the financing problem, the time could hardly be less opportune to restrict access, not just in the interests of individual members, but of the entire world economy.

With regard to the enlarged access limits, Mr. Kafka continued, in theory, he favored allowing maximum absolute access to increase in the present difficult circumstances. There was certainly no advantage in allowing the maximum absolute access to fall, particularly for those countries that had had the lowest increase in quotas, the smallness of the increase quite frequently reflecting their already dangerously low rates of growth. The latest solution described by the staff, although not the staff's recommendation, was to adopt a form of a two-tier proposal as described in the first paragraph of page 4 of EBS/83/172. There was no justification for that proposal. It would require from those members with quota increases below average--precisely the more needy members--a greater degree of justification for the same absolute access, other things being equal, than from those with higher quota increases. A higher access limit did not commit the Fund to grant higher access in the absence of clear need. Limits should be established that, following the increase in quotas under the Eighth Review, would yield all members at least their present absolute access as a maximum in the same sense as at present. No member should be granted more access than absolutely required, but the degree of justification required would be established on a fairer basis than it would otherwise be. The staff's preferred solution did not seem very different from Mr. Wicks's original (in both senses of the word) two-tier proposal. It would also shift the burden of proof against the most needy.

Whether there should be a general rule that maximum access close to the limit should be reserved for cases in which "decisive improvement" could be expected within three years depended very much on the exact meaning to be attached to the term "decisive improvement," Mr. Kafka considered. He invited the staff to comment further on the issue. The Executive Board should not preclude itself from granting exceptional enlarged access, even in cases in which the stability of the entire financial system was not in question. He continued to favor the original staff proposal. He agreed with the staff on the legal inappropriateness of a grandfather clause, and on the economic and operational inappropriateness of applying further reductions in access limits to existing arrangements even if the legal proprieties had been preserved by due warning being given of such a possibility in each future decision. Such a practice would make nonsense of the whole concept of a stand-by or extended arrangement, with dire consequences for the role of the Fund and the financial system itself. Finally, there was no justification for a comprehensive access limit. Before the question of financing was discussed in detail, it would be useful if the staff could provide a concise paper on the subject.

Mr. Erb stated that, as he had mentioned on previous occasions, the position of his authorities on the various policy issues before the Board had been shaped by a number of factors including the temporary balance of payments financing role of the Fund; the relatively favorable prospects for a world economic and financial recovery over the next few years; the need to send a clear signal to governments that adjustment programs should be pursued vigorously and that Fund financing could not be relied on for an indefinite period; and the need for the Fund to live within official financial resources made available to it by governments. In that regard, his authorities had been very careful not to commit more than they could deliver.

Commenting on the ninth issue in the Chairman's statement, concerning the need for continued borrowing by the Fund after the quota increase, Mr. Erb said that his remarks would be general and that he would not discuss the technical issues on the present occasion. He recalled that the staff's estimates of the Fund's liquidity position for the period from January 1, 1984 to April 30, 1986, as presented in Table 3 of EBS/83/79, (4/20/83) suggested that, even with access limits of 102/305/407, the Fund's ordinary resources would decline to SDR 8-10 billion by early 1986 and the borrowed resources required between January 1, 1984 and April 30, 1986 would amount to roughly SDR 8.3 billion. His authorities were concerned about the projected decline in ordinary resources, given that they could not agree to an acceleration of the Ninth Quota Review. Nor would they endorse Fund lending for the coming few years that would eventually require an acceleration of the Ninth Quota Review. In addition, his authorities questioned where the Fund would be able to borrow SDR 8.3 billion. For the next few years, they were not prepared to support private market borrowing, and they doubted whether the conditions for activating the General Arrangements to Borrow (GAB) would continue to exist in the future, especially beyond 1984.

His authorities had reviewed the outcome of the Board's policy discussions, Mr. Erb continued, and they feared that the discussion was drifting in a direction that raised even more questions about whether financing would be found. The position of his authorities with regard to enlarged access limits remained the same: when the increase in quotas under the Eighth Review came into effect, the access limits should be set at 102/305/407. He agreed with the staff conclusions in SM/83/194 that it would not be consistent with the principle of uniform treatment for the Fund to adopt a policy under which access limits in terms of new quotas would apply to one category of members while access limits for others would be determined on some other criterion. He continued to oppose, therefore, the proposal to "grandfather" maximum access amounts available under existing quotas and existing access limits.

He had serious difficulties with the staff's suggestion that a policy could be adopted whereby the Fund would assure members of sympathetic consideration, on an individual basis, of their request for use of the Fund's resources in excess of the established limit, Mr. Erb went on. To date, the Fund had, in practice, followed a policy of providing a waiver of the established access limits in truly exceptional circumstances. The presumption that waivers in individual cases would be rare should be continued, and that the burden of proof lay with those who advocated an individual waiver. He could not support a policy that would create the presumption that some countries would receive more favorable treatment under the waiver provision. Nor could he support a policy that would result in more frequent use of the waiver provision for access beyond the established access limits.

His authorities continued to hold the view that it was necessary to have an agreement now on an explicit phasedown schedule for enlarged access limits beginning in early 1985, Mr. Erb stated. They proposed that limits of 70/210/245 should go into effect in January 1985, and that enlarged access should be phased out in 1986. They also proposed that the method for phasing down should be Method B as outlined in the staff paper entitled "Financial Considerations Related to Enlarged Access" (EBS/83/133, 6/28/83). Under that method multiyear programs negotiated in 1984 would use the planned access limits for 1985 and beyond. As he had stated during the Board's earlier discussion on enlarged access (EBM/83/110 and EBM/83/111, 7/25/83), a phasedown schedule established under the present review could be modified if it were judged in a later review, for example at the end of 1984, that expected world economic and financial conditions did not warrant the scheduled reduction in enlarged access.

Commenting on the issue of whether the Fund could, in the event of a reduction of access limits, reduce the amount agreed to under the existing arrangements, Mr. Erb said that he agreed that it would be undesirable for the Fund to reduce the specified amounts in existing arrangements unless notice of the possibility had been given in the decision granting the arrangement. That situation constituted one reason why his authorities believed that it was necessary to establish now an agreed phasedown schedule so that all countries, as well as the financial markets, would know where they stood. If doubts existed concerning the phasedown schedule, however, the Fund should begin to incorporate in its decisions language that would give appropriate notice that a future change in access limits, and in particular the annual access limit, could be made applicable to the amounts under the arrangement. The subject might require more examination by the staff. One of the factors to be considered was how such clauses could be written so as to minimize uncertainties for a country and lenders to that country.

The scale of enlarged access was an important subject to his authorities, Mr. Erb went on, given their strongly held view that the limits were limits, not access norms or targets, and their view that enlarged access could not be applied in a general manner to all Fund programs. It was also important to convey more explicitly to Fund members the criteria for determining the scale of access within the limits. His authorities believed that it was necessary in the context of the present review to develop guidelines or understandings of how enlarged access would be applied within the limits. They were not contemplating rigid guidelines, since some degree of flexibility should be left to the Fund. It was also important to underscore the exceptional character of the enlarged access decision (Decision No. 6783-(81/40)); it had been established for use only under the circumstances specified in the decision. As his chair had stated in previous general policy discussions of the matter, and as it had stated in the context of specific country requests for the use of Fund resources, his authorities questioned the applicability of enlarged access in circumstances that, in their judgment, interpreted the criteria of the decision too loosely.

The guidelines suggested by the staff in EBS/83/172 provided a useful starting point for the present discussion, Mr. Erb considered. He did not have specific language changes to suggest at the moment, only general comments on aspects of the staff guideline that raised concerns and questions. He had serious difficulties with the staff's attempt in paragraph 3(b) on page 2 to define the exceptional circumstances in which a waiver might be granted. The proposal put forward by the staff appeared to be a significant liberalization of the established practice of providing waivers only in rare circumstances. He also had a problem with the reference at the bottom of page 2 to a period of five years as a reasonable period within which to achieve "a significant reduction in balance of payments pressures enabling the member to make net repurchases to the Fund." Given the temporary character of Fund financing, the Board should not create the impression or expectation that five years would be an acceptable period within which to make a significant reduction in a country's payments maladjustment. In rare exceptions, such a period might be acceptable as the outer limit for achieving a sustainable balance of payments position that eliminated the need for new Fund financing and that permitted a reduction in the outstanding use of Fund credit.

On page 3 of EBS/83/172, the staff identified two general circumstances when more limited access would be appropriate, Mr. Erb noted. The first of those circumstances, outlined in paragragh 5(a), raised questions in his mind about whether the application of enlarged access was appropriate. The second set of circumstances, outlined in paragraph 5(b), raised questions about whether any commitment of Fund financial resources was consistent with the temporary character of Fund financing. He had raised the same questions in the previous discussion of enlarged access policy. It might be, however, that the temporary character of Fund financing would be protected by the additional qualifications provided by the staff that: "In both cases, care should be taken to ensure that Fund financing does not take on a semipermanent character. Within a reasonable period, the member must begin to make net repurchases each year with a view to restoring its credit tranche position."

The staff went on to discuss a two-tier approach in which the second tier would be activated to support follow-on arrangements after the "normal" limits of 102/305/407 had been exhausted, Mr. Erb observed. He had a problem with the reference to those limits as "normal" limits because such wording could be interpreted to mean that normally access would be provided at those limits. More fundamentally, from the way that the staff had described how the two-tier system would work, it appeared that it would not be very different from a limit of 125 percent. However, he remained open to examining that proposal, so long as it was clear that the second tier would be used in exceptional cases.

Commenting on the form of access limits, Mr. Erb agreed that it was not necessary to provide a different comprehensive limit on total access, and that that possibility need not be mentioned in the draft report to the Interim Committee. He did not advocate a change in the existing form of the limits for the special facilities. The limits on the compensatory financing facility should be 65-70 percent of quota for the export and cereal decisions, with a combined limit of 85 percent. He had no major problems with the approaches to lower-tranche and upper-tranche conditionality presented in EBS/83/171, and he would reserve specific comment until later.

Although the subject was not on the agenda before Directors, Mr. Erb remarked, the issue of structural adjustment lending had an important bearing on the potential use of Fund resources. In recent years, the lending objectives of the Fund had broadened to include what had become known as structural adjustment financing. As he had said on previous occasions, his authorities were seriously concerned that that type of financing was moving the Fund too far from its traditional temporary balance of payments financing role. The subject would have to be considered again at a later date, for it was desirable for the Fund to define more explicitly the types of structural adjustment that merited Fund financing, and to set priorities on the lending objectives of the Fund. The Executive Board needed to find a combination of policy adjustments that would achieve the essential objective of living within the resources available in the foreseeable future in a manner consistent with the temporary character of Fund financing.

Mr. Laske commented that the most important aspect of the present discussion was the problem of how to finance a continuation of the enlarged access policy. Only if adequate finance were assured would it be permissible to extend enlarged access in a form and on a scale to be agreed. The necessary financing did not appear to be assured at present, and the question would have to be discussed again later. However, such additional financing would have to come from official sources; his authorities rejected the option of Fund borrowing on the private markets for the reasons that he had outlined on earlier occasions.

Assuming that sufficient financing from official sources would be forthcoming, Mr. Laske continued, he could support a temporary limited continuation of the enlarged access policy. Such a continuation should permit the maintenance of the nominal enlarged access that member countries had in the aggregate under the present formula and based on present quotas. As percentages of the quotas agreed to under the Eighth Quota Review, the limits would be 102/305/407. The staff projections for prospective calls on the Fund's resources under such limits demonstrated that they would lead to substantial borrowing requirements. To go beyond those limits would not be prudent, since to do so would create expectations that the Fund might not be able to meet because of a lack of financing. A number of countries would see their nominal access reduced under such a formula, but the reduction was the unavoidable effect of the selective features of the quota review. Maintaining the nominal access of individual countries through a grandfather clause was not in conformity with the principle of uniformity of treatment, as the staff had convincingly demonstrated in SM/83/194.

A proposal had been made by Mr. Wicks to moderate the reduction by establishing a second tier of access beyond the basic limits established for enlarged access, Mr. Laske noted. His authorities had studied the proposal with interest and great care; he personally believed that it might provide the basis for an eventual resolution. However, his authorities believed strongly that a second tier could be provided only after visible progress under an arrangement within the basic limits had been made, and only after adherence to the program agreed with the Fund had been demonstrated. They feared that the compression of the two stages into one might be understood as removing the distinction between the first and second tiers. A clearly defined line of demarcation had to be drawn between the two tiers. In addition, his authorities feared that the second-tier approach might create additional financing requirements, the coverage of which was rather unclear at the moment. Further consideration of the two-tier system demanded analysis of its potential consequences both for the level of access under individual adjustment programs and for the resulting financing needs before Executive Directors could come to a definite judgment.

He could support a temporary extension of enlarged access at the reduced quota limits, Mr. Laske went on, for example, for one year with the proviso that the policy would cease unless the Executive Board decided on a further extension. He did not favor an open-ended extension with a provision for periodic reviews; those reviews would be inconsequential if no decision were taken. He firmly believed that a start had to be made on a phasedown of enlarged access when the extension under discussion expired. The phasedown should be decided upon forthwith; in that regard, he fully agreed with the views of Mr. Erb. Such a decision should also include the path of the descent to the normal access limits as well as the time by which such a descent would reach "ground level." The beginning of 1987 would be an appropriate point for the final return to normal access limits, i.e., 100 percent of quota for stand-by arrangements and 140 percent for extended arrangements. His authorities attached strong priority to establishing the timetable for the phasedown at present rather than at an undetermined later date. He agreed with the staff's view that the progressive reduction of the access limits during the phasedown period ought not to affect those arrangements in place when the phasedown began.

In EBS/83/172, the staff set out for the first time in precise language the guiding principles that it applied when determining the size of a prospective arrangement, Mr. Laske remarked. Although the description was welcome, he had considerable doubts about the advisability of formalizing such guidelines. Thus, he could not support the suggestion to attach EBS/83/172 as an annex to the Executive Board's report to the Interim Committee. If the majority of Directors believed that such an annex to the report would be appropriate, he would propose certain modifications of the language.

Commenting on the form of access limits and on access under the special facilities, Mr. Laske said that his position had not changed since the previous discussions of those subjects. In particular, a member should be required to cooperate with the Fund for all drawings under the compensatory financing facility, and an adjustment program should be in place or be concluded simultaneously when use was made of the upper 50 percent of the facility. Finally, with regard to simplifying the procedures for use of ordinary and borrowed resources, the liquidity consequences of certain proposed simplifications would have to be carefully considered before Directors could come to a decision.

Mr. Wicks commented that there were clearly wide gaps between the various positions of Directors on the questions before the Executive Board. Therefore, the Board's report to the Interim Committee should cover a range of options to give the members of the Committee the essential building blocks with which to reach broad agreement on the way forward, if that was possible. He hoped that such an agreement would be reached. The availability of resources to the Fund was likely to be a factor, if not the determining factor, in decisions on the scale of access, a conclusion that might be regrettable to some Directors, but one that was unavoidable. The Executive Board could not provide access to resources that were not likely to be available; such an approach would be imprudent and uncharacteristic of the Fund's operations. He hoped that the Board's discussion on the Fund's liquidity position scheduled for September 2, 1983 would lead to conclusions that would provide the basis for reporting to the Interim Committee on the important subject of finance.

He had put forward the two-tier approach at EBM/83/110 (7/25/83), Mr. Wicks recalled. In EBS/83/172, the staff had reformulated his approach so that the two tiers could be run together in such a way that a sufficiently strong program might qualify for support up to the upper limit from the outset, subject to meeting the other criteria for exceptional access. That reformulation was not inconsistent with his earlier suggestion, since he had indicated that the two tiers could be compressed into one in cases of special need. As always, the Board would need to retain final discretion, so that there could be scope for some flexible interpretation of the magnitude of shocks to members' external financial positions. Thus, there were attractions in the staff's reformulation, but he would not wish to discard the possibility of a two-stage approach, and such an option ought to be mentioned in the report to the Interim Committee.

The staff's discussion in Part II of EBS/83/194 confirmed that the two-tier approach could be applied consistently with the long-standing principle of uniform treatment of members, Mr. Wicks considered. If the two-tier approach was to be considered further, Directors ought to define the criteria for access to the second tier--i.e., above 102 percent--in order to ensure that the legitimate financing needs of members were met in a manner consistent with the Fund's basic principles, such as uniformity of treatment, and consistent with the total financial resources available to the Fund. However, in suggesting the need for better defined guidelines, he did not wish to trespass on management's legitimate executive prerogatives. It was important that the Fund's management should have freedom to take appropriate decisions promptly.

The criteria for access to the Fund's resources below the 102 percent ceiling were well set out in Part I of EBS/83/172, Mr. Wicks went on. It should be emphasized that the limit of 102 percent was a ceiling, not a target or an entitlement, although it might be exceeded in special circumstances. The two-tier system was not original in the sense that it represented a break with traditional Fund practice, as Mr. Kafka had suggested. It was, rather, a development of the practice that the largest Fund programs, as a proportion of quota, should be reserved for members with the greatest need and for those undertaking the strongest adjustment. He could certainly agree with the staff's suggestion that one criterion for access to the second tier should be a more rigorous interpretation of the criteria for access to the first tier. Another criterion could be an unusually strong adjustment effort aimed at the early restoration of balance of payments sustainability, and a third could be the existence of a short-term financing need that was exceptionally large in relation to quotas. Those criteria should be explicitly incorporated into the two-tier approach, if it was accepted. A grandfather clause was not an attractive option, but perhaps a similar idea could be incorporated within the two-tier approach, meaning that countries that suffered a reduction in access under the new limits might receive favorable consideration for exceptional access under the two-tier approach, although there would be no automatic entitlement.

The staff would have to interpret whatever criteria were agreed upon consistently, Mr. Wicks observed, and the Executive Board might have to give the staff more explicit guidance in that regard. He welcomed the material presented in EBS/83/172, which attempted to describe the differences between the situations faced by members requesting access to Fund resources. At some stage, the guidelines for access within the limits would probably need to be defined in a similar fashion. Although he did not necessarily agree with the staff's particular formulation presented in EBS/83/172, he had no objection to the paper's being attached as an annex to the Board's report to the Interim Committee, but only as an example of the considerations that had to be borne in mind. In future, the staff would need to justify in detail the reasons for access according to whatever guidelines or criteria were agreed upon, not only for requests for use of Fund resources under the compensatory financing facility, but for access to other facilities as well. Finally, with regard to the two-tier approach, it would be useful if the staff could provide information on the implications of that approach for the Fund's financial position. However attractive the system, it would be difficult to recommend it, if it implied access beyond the prospective resources of the Fund.

Commenting on the phasedown of enlarged access limits, Mr. Wicks stated that the Board should agree on a date on which the new limits should be reviewed in the hope that the phasedown could begin at that point. However, to plan a detailed phasedown path at present would not be useful, given the high degree of economic uncertainty. He agreed with the arguments put forward in Part III of SM/83/194 on the question of reducing the amounts of existing stand-by and extended arrangements, and with the point that the Chairman had made at the outset of the discussion with regard to relations with the commercial banks. He hoped that the Fund would never be in a position in which it had to reduce amounts agreed to under existing stand-by and extended arrangements. With regard to the compensatory financing facility, the individual facilities should be limited to about 75-80 percent, with a combined limit of 100 percent. However, the question of limits was partly bound up with the question of conditionality. Finally, he supported the proposed simplification of procedures with regard to financing, subject to the need to conserve the Fund's ordinary resources; however, such technical matters need not be included in the Board's report to the Interim Committee.

Mr. de Maulde said that it was a valuable exercise to submit a report to the Interim Committee reviewing access to the Fund's resources in order to try to obtain the necessary guidance for Directors' future decisions on the subject. However, at present, no clear consensus could be expected to emerge from the Executive Board on the main question of limits.

He agreed with those Directors, representing approximately one third of the voting power in the Executive Board, who favored what the Chairman had described as a "middle ground" solution, Mr. de Maulde observed. He strongly preferred an access limit of 125 percent of quota. He would have had more sympathy for the two-tier approach suggested by Mr. Wicks if it had been based on access of 125 percent and 150 percent instead of 102 percent and 125 percent. The present version of the proposal appeared to be restrictive. There would also be practical difficulties in administering the system that might create considerable differences of treatment for members, depending on whether they had been allowed access to the upper tier or not. The result would be a burdensome, overbureaucratic set of regulations out of touch with reality.

A major disadvantage of the two-tier approach was that it presupposed that the Board was unable to make responsible judgments on the extension of the Fund's resources to member countries, taking into consideration both the needs of members and the amount of resources available, Mr. de Maulde continued. He believed that the record of the Executive Board showed that it was quite capable of making such judgments without resorting to predetermined criteria that attempted to define a border between two sets of access limits. The application of the proposed system would create inequality of treatment between a country that had obtained access to the higher limit at the outset and a country that had not done so, but which at a later stage entered a situation in which it met all the criteria for access to the upper tier. In such circumstances, the case of the latter country ought to be reconsidered, and it should be able to obtain additional financing, but, as he understood it, the reformulated two-tier proposal did not provide for that possibility.

Those Directors who favored immediate agreement on a timetable for the phasedown of enlarged access limits appeared to assume that economic recovery in the near future would diminish the balance of payments needs of member countries and, thereby, the need for Fund financing, Mr. de Maulde suggested. Speaking personally, he could favor such an approach to a phasedown as long as it would be possible to alter the path if the assumptions about economic prospects or the availability of Fund resources should turn out to be invalid. Such an approach ought not to be rejected, provided that the figures on which it was based were reasonable and realistic.

He agreed with the points made in Section II of SM/83/194, Mr. de Maulde stated. He also agreed with the staff on the question of reducing the amount of existing stand-by and extended arrangements. The Fund's purpose was to give confidence to member countries by making its resources available to them. To make the amount of Fund credit extended in support of an adjustment program uncertain and subject to future reduction would defeat the purposes of the organization; as the Chairman had pointed out, it would also complicate financing arrangements with commercial banks. He could not support a comprehensive limit on total access. Finally, with regard to financing, his authorities were conscious of the limitations placed on the Fund's actions by financing problems and of the need to arrive at decisions on an access policy that could be implemented in practice.

Mr. Hirao said that he generally endorsed the staff description of the principles governing enlarged access. It was clear and comprehensive. In determining members' access to Fund resources in individual cases, the provisions of the Articles of Agreement and relevant Board decisions should be rigorously applied. Because the enlarged access policy had been established to cope with exceptionally difficult international payments imbalances, extreme care had to be taken in analyzing the factors that justified the need for enlarged access in each individual case. Considerable care had been exercised in the past, and that sound practice should be continued. The policy should not be applied with rigidity; there should be leeway for the Fund's management within a reasonable limit. However, a general guideline was still needed, and it had to be properly applied to ensure the equitable treatment of members. He stressed the point made by the staff in EBS/83/132: "In the future, when presenting requests for the use of Fund resources, the staff papers would be more explicit both as to the way in which these amounts are determined, and as to the prospective balance of payments situation at the time when repurchases fall due." It should also be emphasized that Fund financing should not take on a semipermanent character. There had to be the prospect of a significant improvement in a country's balance of payments position within a reasonable period.

Commenting on the two-tier approach, Mr. Hirao considered that Mr. Wicks had made a thorough and persuasive argument. He agreed with most of his points, and he could support the two-tier approach in which limits of 102/305/407 would normally be applied but higher limits of 125/375/500 would be available in exceptional cases. Such an approach could be a practical solution. The criteria for exceptional access would have to be clearly defined in order to ensure equitable treatment of members. The three conditions suggested by Mr. Wicks would serve as a good minimum basis for such criteria. First, the arrangements had to be associated with unusually strong adjustment efforts. Second, there should be a short-term balance of payments financing need that was exceptionally large in relation to quota; and third, the exceptional need should result from major unforeseen external events.

The staff clarification of the grandfather clause had been useful, Mr. Hirao went on. He had suggested such an approach as a possible compromise solution that might win early agreement. However, because it had not gained broad support, he did not wish to pursue it further at present. As the enlarged access policy was a temporary expedient, and as external imbalances were likely to improve in the coming years, reflecting the major adjustment efforts currently being undertaken, he did not believe that the Board should agree that the phasedown of enlarged access limits could begin at a certain stage. Periodic reviews, perhaps yearly, would be appropriate. They should take into account the prospective demand for the Fund's resources and the Fund's liquidity position, with a view to fixing a timetable for the phasedown. With regard to the question of the reduction in the amount of existing stand-by and extended arrangements, he understood the doubts raised by the staff. Nevertheless, Directors should not exclude the possibility of further exploration of such an approach, perhaps on a case-by-case basis when circumstances warranted it.

Commenting on the establishment of a comprehensive limit, Mr. Hirao said that he agreed with the position set out by the Chairman. His views remained unchanged on the question of access limits for the special facilities. Since the average increase in members' quotas was 47.5 percent, the quota limit under the compensatory financing facility for exports and for cereals could be reduced to 68-70 percent, and the combined limit to 85 percent. Similarly, the buffer stock financing facility limit could be set at 34 percent. Given the importance of the Fund's responsibility to promote adjustment through members' use of its resources, it would be appropriate to reduce access to the special facilities by a greater proportion than access to the regular facilities, thereby striking an appropriate balance in the use of Fund resources.

The Executive Directors agreed to resume their discussion in the afternoon.

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Miss Le Lorier on the completion of her tenure as Alternate Executive Director to Mr. de Maulde.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/125 (8/29/83) and EBM/83/126 (8/31/83).

4. ZAIRE - 1983 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/83/222 (8/26/83). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1983 Article IV consultation with Zaïre to not later than November 9, 1983.

Decision No. 7509-(83/126), adopted
August 30, 1983

5. 1983 ANNUAL MEETINGS - OBSERVERS

The Executive Board approves the proposal set forth in EBD/83/205, Supplement 2 (8/25/83).

Decision No. 7510-(83/126), adopted
August 30, 1983

6. EDUCATION ALLOWANCE - EXTENSION OF ADJUSTMENTS TO EXECUTIVE DIRECTORS AND ALTERNATES

The Executive Board approves the recommendation set forth in EBAP/83/219 (8/26/83).

Adopted August 30, 1983

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/55, 83/56, and 83/57 are approved. (EBD/83/221, 8/24/83)

Adopted August 30, 1983

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/218 (8/26/83) is approved.

APPROVED: February 29, 1984

LEO VAN HOUTVEN
Secretary