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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/83

10:00 a.m., June 5, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	W. K. Parmena, Temporary
	Song G., Temporary
	M. K. Bush
	E. L. Walker, Temporary
J. de Groote	
A. Donoso	
M. Finaish	T. Alhaimus
G. Grosche	
	J. Reddy
	J. R. N. Almeida, Temporary
	M. Foot
	O. Isleifsson, Temporary
	D. McCormack
	D. Saha, Temporary
Y. A. Nimatallah	L. P. Ebrill, Temporary
	L. Filardo
	S. de Forges
	G. Pineau, Temporary
	J. de Beaufort Wijnholds
C. R. Rye	
	O. Kabbaj
	V. K. Malhotra, Temporary
	M. Sugita
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
V. Wall, Assistant

Also Present

Administration Department: K. Craig, D. S. Cutler, R. H. Floyd, W. B. Hobbs, J. B. Kaiser, P. J. McClellan, G. Vaughan. African Department: A. D. Ouattara, Counsellor and Director; R. J. Bhatia, Deputy Director; J. M. Jimenez, D. J. Scheuer. Asian Department: R. J. Corker, W. G. L. Evers, F. Le Gall, B. Nijathaworn, D. A. Scott. European Department: B. Rose, Deputy Director; U. Dell'Anno. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; H. B. Junz. Legal Department: F. P. Gianviti, Director; W. E. Holder, Deputy General Counsel; P. L. Francotte, A. O. Liuksila, J. M. Ogoola, J. S. Powers. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, D. Berthet, D. H. Brown, J. C. Corr, D. Gupta, B. Zavoico. Western Hemisphere Department: M. Caiola, H. Flickenschild, C. M. Loser. Office of the Managing Director: R. Noë, Internal Auditor. Advisors to Executive Directors: M. B. Chatah, L. P. Ebrill, A. Ouanes, G. Pineau, I. Puro, I. Sliper. Assistants to Executive Directors: M. Arif, F. Di Mauro, V. J. Fernandez, M. Hepp, S. King, K.-H. Kleine, M. A. Kyhlberg, M. Lundsager, R. Manfredi Selvaggi, T. Morita, S. Rebecchini, V. Rousset, G. Seyler.

1. ITALY - VOLUNTARY CONTRIBUTION ACCOUNT - ESTABLISHMENT AND ADMINISTRATION FOR SOMALIA

The Executive Directors considered a staff paper on the establishment and administration of a voluntary contribution account at the request of Italy for the benefit of Somalia (EBD/87/149, Sup. 1, 6/4/87).

Mr. Zecchini said that the request to the Fund to open an account for the administration of resources to be contributed by Italy was for the purpose of facilitating the resumption of the Fund's financial assistance in support of Somalia's adjustment efforts. Once the transactions had been completed, the account would be closed. The main objective was to assist Somalia in promptly settling its overdue financial obligations to the Fund, which would allow the resumption of discussions concerning Somalia's use of the Fund's resources under the structural adjustment facility.

The initiative constituted the first implementation of a proposal he had presented the previous year on the occasion of the Board's discussion of the problems of countries with overdue obligations, Mr. Zecchini recalled. On that occasion, he had suggested that some countries might contribute funds on a unilateral basis to alleviate a country's overdue obligations and thus allow its adjustment program to continue. The Board could authorize the establishment of the account, as set out in the annex to EBD/87/149, since the terms were consistent with the Articles of Agreement.

Mr. Donoso, Mr. de Groote, Mr. Nimatallah, Mr. de Forges, Mr. El Kogali, Mr. Kabbaj, Mr. Malhotra, and Mr. Song said that they supported the proposed decision and that Italy was to be congratulated for its initiative.

Mr. Grosche commented that although he supported the proposed decision, it was important that the Fund should not allow the administration of future accounts to generate additional costs.

Ms. Bush, Mrs. Filardo, Mr. McCormack, and Mr. Sugita, in supporting the proposed decision, reiterated the note of caution sounded by Mr. Grosche.

Mr. Finaish remarked that the initiative on the part of Italy was welcome, and he expressed his appreciation to the Italian Government on behalf of the Somali authorities.

The staff representative from the Treasurer's Department noted that there were no liabilities to the Fund regarding the account, and there were no significant costs. In addition, the staff had made arrangements with the Federal Reserve Bank of New York to open the account promptly upon the Executive Board's approving the decision.

Mr. Zecchini commented that had there been any costs in administering the account, the Italian Government would have assumed them. However, as a cooperative international institution, the Fund should examine cost considerations in light of the particular nature of the request.

The Acting Chairman commented that the Bolivian authorities had approached the Fund to obtain its assistance in administering a similar account to facilitate a debt buyback arrangement that Bolivia had negotiated with commercial banks and that was to be financed by assistance from donors. The matter had not been pursued further pending the outcome of the Board's discussion of the request of Italy to establish an account for the benefit of Somalia.

Mr. Foot noted that the two cases were of a different order of magnitude and that they raised quite different questions. If the staff decided to proceed with discussions with the Bolivian authorities, the Board should have an early opportunity to discuss the matter.

Mr. Grosche remarked that the Fund should not take over services that could be provided by other institutions, particularly the banking community. Indeed, the Fund should express reluctance to expand its involvement in such activities, unless they fell within the framework of the Articles, in which case he agreed that the Board should consider the matter. As for the Bolivian request, he was in agreement with Mr. Foot that the Board should discuss the issue before any commitments were made.

Mr. Nimatallah commented that there were two objectives: to help Somalia put its economic affairs in order, possibly through a structural adjustment arrangement, but foremost, to retrieve the money that was overdue to the Fund. Therefore, he would like to hear from Mr. Zecchini as to when the contribution would be placed in the account and from Mr. Finaish as to what steps the authorities would take thereafter.

Mr. Zecchini remarked that he was ready to consider the interesting initiative mentioned by the Acting Chairman with respect to establishing a voluntary contribution account for Bolivia. He did not share the doubts that had been expressed in that respect because the money, which would come from various official sources, would otherwise have been administered on a bilateral basis by the governments concerned. If the operation could be better administered by a multinational institution like the Fund, then he supported the initiative.

As for the timing of the disbursement for the account for Somalia, Mr. Zecchini said that although complex procedures were involved, all efforts were being made to have the money in place by June 12. If that were not possible, the money should be in place on the following day or two thereafter.

Mr. Finaish asked if the Board would agree to an early issuance of the staff papers on Somalia's requests for stand-by and structural adjustment arrangements, given Somalia's intention to clear its arrears as soon as the voluntary contribution account was in place, hopefully by June 12. The staff papers should be discussed by the Board on June 17 if possible because there was a Paris Club meeting on June 19, 1987.

Mr. Nimatallah remarked that he could support Mr. Finaish's request, based on the assurance given by Mr. Zecchini that the money would be placed in the account by June 12.

Mr. Foot noted that it would be helpful if the Treasurer's Department could tell the Board whether the money being provided by Italy was certain to be enough to clear all arrears.

The staff representative from the Treasurer's Department noted that, owing to recent exchange rate developments, SDR 200,000-300,000 would remain unpaid after the payment from Italy had been received. However, a commercial bank was willing to cover that amount. The two payments would make Somalia current with the Fund.

The staff representative from the African Department remarked that the SDR 200,000-300,000 discrepancy was due to movements in the exchange rate of the dollar. The commercial bank in question had already committed $22 million in the bridging operation and was certain to protect its interest by providing whatever additional resources were needed. As for the timing of the Paris Club meeting, the staff was concerned about any eventuality that could possibly lead to an increase in the financing gap for Somalia in 1987. To permit continued implementation of the 1987 program, it was important for the authorities to have an early indication of the likely levels of assistance from a large number of non-Paris Club donors, who usually awaited the outcome of Paris Club agreements.

Mr. Foot commented that he had trouble with the shorter timetable for Board discussion of Somalia because of the need for comparability with the treatment of other countries. He recalled that a number of countries had secured bridging finance for several weeks to allow a reasonably lengthy period of discussion among the international organizations concerned.

Mr. El Kogali noted that overdue obligations were a great problem for the Fund. If a country had made efforts to find a donor, an early indication of financial assistance was important. Therefore, he supported the request of Mr. Finaish.

Mr. Nimatallah and Mr. Kabbaj said that they also supported Mr. Finaish's request.

Mr. Grosche remarked that, on an exceptional basis, he supported Mr. Finaish's request.

After further discussion, the Board accepted Mr. Finaish's request for early issuance of the staff papers on Somalia's requests for stand-by and structural adjustment arrangements, thereby enabling the Board to hold an early discussion of the requests, provided the arrears to the Fund were settled.

The Executive Board then took the following decision:

1. Pursuant to Article V, Section 2(b), the Fund adopts the provisions set forth in the Annex to EBD/87/149, Supplement 1 (6/4/87) that establish an Account for the administration by the Fund of resources to be contributed by Italy for Somalia.

2. The provisions of the Annex may be amended only by a decision of the Fund and with the concurrence of Italy.

Decision No. 8604-(87/83), adopted
June 5, 1987

2. VANUATU - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Vanuatu (SM/87/107, 5/13/87). They also had before them a background paper on recent economic developments in Vanuatu (SM/87/116, 5/22/87).

Mr. Rye made the following statement:

My Vanuatu authorities are in broad agreement with the consultation report and regard it as fair and well balanced. The report is helpful in illustrating the long-term nature of the development process and in bringing out some of the special constraints facing a small island economy. Naturally there are differences of view on some aspects, although these are more points of emphasis and priority than fundamental differences about approach or policy direction.

Since independence in 1980, economic growth in Vanuatu has fluctuated considerably. From a flat period in the early part of the decade, growth resumed at a steady 2-3 percent in 1982 and 1983, increasing to 5 percent in 1984, only to flatten out or become slightly negative in 1985 and 1986. The outlook for 1987 is for a small decline in real GDP. The poor performance in the past three years has been caused largely by external events, including damaging cyclones in 1985 and February 1987 and dramatic declines in copra prices and in tourist receipts. As regards the prospect for the medium term, the cautiously optimistic tone of the report seems justified given the encouraging export diversification effort and the scope for some pickup in tourism.

I shall comment on four of the constraints or structural bottlenecks that have been highlighted in the report--the lack of skilled labor, the narrow budget revenue base, the uncertainties surrounding land tenure, and export diversification.

My authorities agree with the emphasis in the report on the need to improve education and to raise the skills of the labor force. The Government has substantially increased the budgetary funds allocated for education. Also, it is expected that an IDA credit--in conjunction with bilateral aid funds from Australia--will be negotiated shortly to improve access to secondary education, curriculum development and teacher training; and the Asian Development Bank will be sending a mission soon to evaluate improvements in vocational education.

On the tax system, the Government does recognize the need to broaden the revenue base away from its present heavy dependence on customs duty, which accounts for 70 percent of total tax receipts. The authorities do not consider, however, that it is timely to institute an income tax. The Government prefers to concentrate its efforts in the near term on the proposed turnover tax, on which legislation will be introduced next year. The authorities also point out that the taxable income base is likely to be very narrow given that many of the larger incomes are earned by expatriates employed under aid programs or by multilateral agencies who would need to be exempt.

The report refers to difficulties relating to land leases and the fact that uncertainty regarding ownership of land constitutes an obstacle to agricultural development. My authorities believe that the report somewhat overstates the extent of this problem. They point out that legal provision does exist for the Government to issue a lease in the event of a long-running unresolved dispute about ownership. Similarly, there is provision for a trust fund to be established in order to hold the rents until the ownership issue is resolved.

On the matter of export diversification, the authorities attach very high priority to this objective and some successes are being recorded. For example, the manufacturing sector has grown steadily in recent years and now accounts for 5 percent of GDP. A number of industrial projects are in the pipeline on the basis of joint ventures or wholly foreign-owned enterprises. Similarly, in primary production there have been encouraging developments in forestry, beef, fishing, and cash crops such as kava, and also nontraditional crops including vanilla and peanuts. Much of the diversification effort is directly assisting the native population in the subsistence agriculture sector. I should add that my authorities agree with the staff view that STABEX (export earnings stabilization facility of the European Communities) funds should be used to foster crops other than copra and for the development of rural infrastructure.

In the next few years the Government will be engaged in the major task of reconstructing the economy as a result of the extensive damage caused by Cyclone "Uma" in February 1987. While the report is correct in suggesting that the cyclone did not cause great damage to the agricultural production base, the damage in Port Vila was extensive, which will have a continuing impact on tourism and financial and administrative services.

At the beginning of this week the Government of Vanuatu held a meeting of aid donors in Port Vila to coordinate efforts to reconstruct the economy. In all, 52 projects were identified involving reconstruction and rehabilitation work. Twenty delegations attended the meeting which included representatives from the multilateral lending agencies. At the meeting donors committed nearly $10 million for specific projects, representing about 65 percent of the funds sought. Donors also expressed support in principle for the remaining projects but indicated that final approval would require reference back to capitals.

My authorities are extremely gratified with this response and have asked me to express their warm appreciation to the donor countries concerned. The high degree of support is especially pleasing given the rather hurried nature of the meeting.

These commitments and pledges represent new aid money for Vanuatu. Implementation of the projects will allow vital rebuilding to proceed and will lay the groundwork for the economy to achieve modest growth in the next few years. In this regard the authorities have confirmed their determination to continue with their cautious economic management program including tight financial policies, flexible management of the exchange rate and a cautious approach to incurring new debt.

Mr. de Groote noted that Vanuatu had suffered an 80 percent reduction in the price of its most important export commodity, copra. In addition, it had lost a significant share of its receipts from tourism because its airline was no longer functioning. Also, it had suffered major damage from a cyclone and had had some difficulties resulting from its currency's appreciation vis-à-vis the Australian currency. In spite of those problems, the country had managed to maintain a stable rate of income growth. Indeed, Vanuatu had weathered its extreme difficulties by using its own high level of reserves and could probably completely recover by simply continuing to use them.

Because of the existence of those strong reserves, the staff's comments concerning the policy on public finances were too critical, Mr. de Groote considered. It was extremely difficult for a country facing such hardship not to increase government expenditures substantially to cover the costs incurred as a result especially of the cyclone as well as those created by the decline of the price in copra. However, in general, he was in agreement with the suggestions made by the staff, especially the suggestion to improve the tax system. At present, most of the tax revenue was provided by a customs tax, which was counterproductive. Taxation of income would be welcome.

He was also in agreement with the staff that it was necessary to reorganize the system of land tenure, Mr. de Groote went on. Furthermore, it was necessary for the country to diversify its economy. At present, Vanuatu depended almost entirely on copra and tourism. The World Bank should be able to assist, especially for diversifying agriculture and meat production. Furthermore, STABEX funds should be used to support infrastructure development, rather than just for supplying capital for the budget.

A different problem was constituted by the exchange rate of the vatu vis-à-vis the Australian currency, Mr. de Groote said in closing. He wondered if it was a good idea for Vanuatu to appreciate its currency in real terms vis-à-vis the Australian dollar, given the fact that Australians provided the largest tourist income.

Mrs. Walker made the following statement:

> Vanuatu experienced a difficult year in 1986, particularly with the damage caused by the cyclone. Both the budget and the overall balance of payments incurred large deficits after having recorded surpluses in the past. In addition, the substantial decline in copra prices negatively affected the current account. While the deterioration in the accounts last year reflects somewhat temporary factors, there are structural weakneses in the economy that make recovery more difficult and need to be tackled in order to enhance development prospects.
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> The authorities have taken steps to redress the deteriorating fiscal situation through the 1987 budget, which are welcome, particularly the transfer of responsibility for the implementation of some public works projects to the private sector and the privatization of other government activities. However, customs receipts may not be as high as projected, and additional expenditures owing to the cyclone may raise the deficit to 2 percent of GDP. In addition, the underlying fiscal position remains weak. In particular, it appears that a gap will emerge in the future between revenue and expenditure. One way to increase revenue would be to reduce the exemptions on taxable imports. In addition, the imposition of an income tax, with proper safeguards, could be effective in generating revenue. However, the authorities do not feel that an income tax would necessarily be the appropriate course and instead will concentrate their efforts on a turnover tax. I would be interested in staff comment on this proposal. In any case, some substantial effort to increase revenue in the medium term will be necessary, particularly if external budgetary assistance is reduced and current development expenditures continue to increase.

The policy objectives of the Second National Development Plan that is under preparation--to which the authorities attach much importance--again call for better utilization of resources through diversification of production and more balanced regional development. Indeed, this Plan is very important, particularly given the fluctuation in prices recently experienced in the copra sector. In this regard, while there appears to be some disagreement between the staff and the authorities on the extent to which problems with land ownership are interfering with development, it does appear that additional efforts to solve this problem would be useful. In addition, she wondered if Mr. Rye would comment on the possibility of passing a foreign investment law that would encourage new investments, particularly in some of the regions currently in need of development funding.

Improvements in the lending mechanisms of the Vanuatu Development Bank could also provide needed capital for rural development, and the authorities should consider the staff recommendations in this regard. Furthermore, using STABEX funds for promoting agricultural diversification and transportation in rural areas rather than as income supplements would be helpful. I welcome the authorities' intention in this direction.

Finally, while the overall balance of payments may show a surplus in 1987, it is projected to show deficits for the remainder of the decade. We welcome the fact that Vanuatu can finance most of this deficit without borrowing on commercial terms. Regarding the exchange rate, the authorities should continue to follow the flexible policy that will maintain the vatu's competitiveness.

The staff representative from the Asian Department commented that the authorities preferred to peg their currency to the SDR for ease of administration and because Vanuatu was an offshore banking center, and many deposits from abroad and locally were made in SDRs. However, they were also aware that the tourist trade, as well as much of their commercial trade, was with Australia. Therefore, the Australian dollar was important in the determination of the exchange rate, as reflected in their recent policies. Since the previous year, the authorities had devalued the vatu three times precisely because it had appreciated against the Australian dollar. Currently, the vatu was still appreciated against the Australian dollar, but the authorities did not feel that it was overvalued. At the moment, Vanuatu was capable of attracting tourists from Australia because its prices were competitive with neighboring countries. However, the authorities would continue to look at the situation closely and were prepared to make a further adjustment in the exchange rate if the tourist trade remained sluggish.

A question had been posed about the income tax and the proposed sales tax, the staff representative continued. The budget problem was two sided in that development expenditures were expected to increase rapidly at the same time that the budget subsidies from major donor countries would gradually be phased out. The current tax system relied heavily on import duties and indirect taxes. Therefore, while the authorities agreed with the staff that that situation should be changed, they felt that an income tax was not politically feasible at the moment; nevertheless, it would be considered in future. Currently, the authorities were concentrating on a sales tax that was slated to be implemented sometime in the coming year. The staff's calculations were that the sales tax would yield about VT 30 million. However, an income tax would yield about VT 300 million, and the current budget subsidies, which were to be discontinued, were about VT 200 million. Therefore, it remained to be seen if the authorities could avoid broadening the tax base to include an income tax.

The investment law was still being drafted, the staff representative said. The authorities would concentrate on making investment attractive in Vanuatu by giving tax concessions and by liberalizing the system of work permits, which was important if expatriates were to be able to work in Vanuatu in connection with the foreign investments.

Mr. Rye noted that given the volatility of Vanuatu's currency since the beginning of 1985, the suggestion to peg the vatu to the Australian dollar was not a good idea. In fact, pegging the vatu to the Australian dollar would create new problems to the extent that it could be questioned whether it would be an improvement over the existing system.

On the issue of land tenure, cultural links to the land had always been extremely strong, Mr. Rye remarked. In what was a largely subsistence society, those links had become even more important upon the advent of independence.

His authorities were gratified at the highly successful results of the donors meeting held in Port Vila earlier that week, Mr. Rye said in closing. The results had surpassed the authorities' expectations, for which they were highly appreciative.

The Chairman made the following summing up:

Directors were in agreement with the basic thrust of the staff appraisal for the 1987 Article IV consultation with Vanuatu. It was noted that during the last two years, the growth and balance of payments performance had been adversely affected by severe cyclones, reduced demand in major tourist markets, and a sharp drop in the world price of copra.

Directors observed that, despite recent measures to raise more revenue and stem the growth of expenditures--and while recognizing the need for government expenditures to repair cyclone damage--the underlying fiscal position remains weak, especially in view of declining budgetary assistance from abroad and rising current expenditures associated with the coming on stream of new development projects.

Because prospects for further revenue growth from import duties and other indirect taxes are limited, Directors noted with approval the proposal to introduce a turnover tax; they advised that further consideration be given to the introduction of an income tax; they saw room for rationalization of the system of tax exemptions and urged additional expenditure restraint. They also suggested that the Government allocate a larger share of funds received from STABEX for the improvement of the rural infrastructure and crop diversification.

Directors indicated that the Second National Development Plan would provide a good opportunity to bring the Government's land policy into clearer focus and also to encourage foreign productive investment.

Directors also noted that the restoration of property damaged by the cyclone of February 1987 will pose a heavy burden on the balance of payments in the years to come. However, with foreign reserves of the banking system at a relatively high level, it would appear that the projected deficits could be financed from Vanuatu's own resources. In addition, Directors noted the positive response of aid donors at the recent donors' meeting.

Taking into account the real effective appreciation of Vanuatu's currency, Directors welcomed the greater flexibility in the determination of the exchange rate and urged the authorities to keep the exchange rate under active review.

It is expected that Vanuatu would remain on the 18-month consultation cycle.

3. OFFICE SPACE - STUDY ON ACQUISITION OF PROPERTY

The Executive Directors considered a staff paper on the leasing of additional office space and the undertaking of a feasibility study on the acquisition of the Western Presbyterian Church property (EBAP/87/61, Sup. 1, 5/15/87).

Mr. Rye made the following statement:

The arguments in favor of leasing additional space at International Square can be reduced to two: that leasing additional space would give the Fund the security of being prepared for the anticipated increase in staff over the next few years and that the depressed commercial rental market in this area at present would allow for lower fitting-out costs than would otherwise be possible.

While these points have considerable immediate appeal and, indeed, validity, the case against the proposal is strong. In the first place, there is no immediate need for the space; based on calculations in the staff paper, it might not be fully required for at least five years. In the meantime, there would be considerable costs. Moreover, as the paper admits, there are many imponderables in assessing manpower requirements over the years ahead, suggesting that a cautious approach should be adopted.

While the market is soft at present, it may continue to be so for some time, particularly given the amount of office construction in this vicinity at present and the fact that the reorganization of the World Bank is likely to lead to additional accommodation becoming available nearby. I am not convinced, therefore, that we should overvalue the security-of-supply argument.

In any case, I think there is a more basic reason for questioning this idea. We have had a policy of budget stringency in recent years, and in my view the proposal would challenge that policy. The good reputation of the Fund owes much to its record of being a lean organization. The original recommendation was put forward on the basis that "it was consistent with the Fund's budget stringency." I agree with that sentiment, and I do not think we should depart from that approach.

As concerns the second matter, the recommendation for a feasibility study into acquiring the Church property, I have no objection. The cost of $150,000 for the study, while not negligible, would be money well spent if it leads to a breakthrough in bringing the Fund's activities to one site.

Mr. Foot remarked that he was in agreement with Mr. Rye's reasoning. It was difficult for the Board to justify action such as leasing additional office space without knowing what it would be used for. Although leasing additional space was perhaps economical, he would hate to discover in future that extra office space had encouraged the acquisition of unnecessary additional staff.

Mr. Reddy made the following statement:

Like Mr. Rye and Mr. Foot, I have difficulty in supporting the proposal for additional office space for at least four reasons:

First, the immediate need for office space has been met by the recent decision to lease 55,000 square feet. The proposal to lease additional space is based not so much on actual present day needs as on perceived future needs.

Second, once additional space is acquired, the tendency will be to use it up. This would mean further additional expenditures.

Third, the Board has already decided that the Fund should remain a lean institution, and that economy should be exercised in all areas, including in the deployment of staff. Next week, the Board will lengthen the Article IV consultation cycle for many members, and I hope that the adoption of these new procedures will make possible the redeployment of staff without the need for an increase in the total size of the staff in the coming years.

The fourth reason for my reluctance to support the proposal is that under the current procedures for determining charges on the use of Fund's ordinary resources, all additions to the operating costs of the Fund are passed on to borrowing members in the form of higher interest rates. As we all know, the rate of interest is now very close to the market rate, and the concessional element in Fund lending has become negligible. Unless the Board decides on a new formula for sharing increased costs, this chair would have difficulty in supporting additional expenses other than those considered absolutely essential for the Fund's operations.

I could support the second proposal for a feasibility study related to the acquisition of the Church property.

Mr. Wijnholds commented that he supported the feasibility study to acquire the Western Presbyterian Church property. Despite the fact that the staff had presented a good argument to lease additional office space in a market situation that was favorable, it would be necessary to ascertain more information in order to determine the implications in full. For example, the subletting of some 25,000 square feet of the additional space mentioned by the staff would indeed be helpful if it constituted a substantial offset of the entire rental fee. In short, it was necessary for the staff to elaborate somewhat more on the possibilities.

Mr. Grosche, Mrs. Filardo, and Mr. Pineau said they had no problem with undertaking a feasibility study of obtaining the Western Presbyterian Church property, but, like Mr. Wijnholds, they wished to have more information on the possibilities of subletting and to what extent it could offset the total costs.

The staff representative from the Administration Department remarked that 25,000 square feet was currently sublet at rates essentially comparable to what the Fund would be paying. The subleases would come up for renegotiation in August of 1987, when they could be renegotiated or discontinued if the Fund so desired. An opportunity also existed to sublet even more of the available space, but it was not as certain as continuing the ongoing subleases currently in force.

There were a number of components to the feasibility study to acquire the adjacent Church property, the staff representative continued. For example, it was necessary to determine what sort of facility the Western Presbyterian Church would require on a new site--how much of the building would be devoted to the Church itself and how much to other activities, such as Sunday school. Therefore, part of the study would deal with identifying sites. Another part would entail the architectural drawings that would tie in the concept of the facility with the potential site. There would be a component that dealt with the zoning laws of the District of Columbia regarding the potential sites. There would also have to be a study of cost and time estimates for the movement of the Church to any particular site, as well as any preparatory work to the actual site in order to make it available for construction.

Developing the concept of the Church facility would cost $20,000, the staff representative went on. The payment to a person familiar with the available property in the Washington area for that kind of market would cost roughly $30,000. The architectural exercise would cost on the order of $60,000. The zoning considerations would be handled by the legal firm customarily used by the Fund in Washington, at an estimated cost of roughly $30,000. The cost/time estimates for management would run about $10,000. The total cost of the study would be $150,000.

Mrs. Walker asked the staff what the net dollar figure would be for rental of all the space available--the costs of the additional option plus the cost for the area that the Fund had already leased.

The Deputy Director of the Administration Department said that the additional costs involved in taking the new space were the fitting-out costs, which would increase by $1.1 million, and the initial annual rental, which would increase from $1.63 million to $2.44 million. Based on the proposition that essentially the subleasing would offset the additional costs, the staff did not see substantial additional costs arising over the next few years until such time as the Fund came to use all of the space.

Mr. Grosche remarked that in addition to the $1.1 million for the fitting-out of the space, there would be about $4.50 million committed to rental in order to have the space available in four to five years. If the Fund opted not to rent the space and saved the money, it would perhaps be necessary to spend even more at a later date. However, the Fund would have saved $4-5 million, and with interest it would be possible to rent even very expensive space for a number of additional years.

The staff representative from the Administration Department commented that the renegotiated subleases would bring in the same amount of money that the Fund would be paying for the leased space. In addition, there would be no U.S. tax on the subletting of the facility because it could properly be considered a Fund activity.

Mr. Ebrill noted the need to clarify the cost comparisons. Were the fit-out costs once and for all, or in two years would an outlay for extra fit-out costs that would include the marginal increment be necessary? If the net usable area increased by more than 100 percent, then the difference in savings for the extra space would not be $1 but $4. Would some economies of scale be lost if the extra space were not rented immediately?

The staff representative from the Administration Department stated that the fit-out costs were a one time cost. The fact that there was not an exact doubling of the fit-out costs in the staff paper was that there were economies of scale. The fit-out of the kitchen and cafeteria in the first increment of 55,000 feet had its own intensified costs attached to it. The economies were front-loaded, so to speak.

Mr. Wijnholds pointed out that the rental company was making financial concessions on the order of $1.5 million. Would that amount be available if the Fund made a later attempt to rent the same space?

The staff representative from the Administration Department commented that the concessional costs, which had been negotiated by the staff, were substantially a condition of the current market. There was no assurance that the same sort of package would be available at a later date.

Mr. Foot noted that the staff's assumption for subleasing income appeared to be on the high side. Also, for how long a period would the Fund offer leases? If the Fund decided to expand, what amount of time would be required to give notices to the subtenants and take over the space for the Fund's use?

The staff representative from the Administration Department said that the current subtenants had occupied the space approximately five years, the same length of time that the Fund had been renting from the building's owners. Therefore, the rental rate for the subleases was similar to the Fund's rental rate. The Fund was currently paying $31 per square foot for the space, and the additional large package was available at $28.50 per square foot. The $28.50 per square foot charge for subleasing was not out of line with what the tenants were currently paying. As for the second question, it was the Fund's intention to structure the term of the subleases to correspond with the Fund's view on when it would need the various pieces of property.

Mrs. Walker commented that apparently the Board felt that the staff and management needed to analyze some of the questions about future staffing needs. It was essential to answer questions concerning manpower needs prior to making a cost benefit analysis that would truly enable the Board to determine whether or not to rent additional space at present.

The Deputy Director of the Administration Department said that it was difficult to answer the question of manpower requirements. The issue was subject to a number of imponderables about the Fund staff, the future work program of the Fund, and other factors such as automation. For example, recently most pressure for additional space in the Fund had come from the considerable expansion of data processing equipment throughout the building.

Mr. Kabbaj remarked that the Board did not have all the information it required to make a proper decision. When management was convinced that there were cost benefits to an operation, the Board should be accommodating.

However, the staff should have explored the possibilities for leasing space opened up by the reduction in staff in the World Bank. Also, like others, he felt that it was necessary to have a full discussion in the Board of what the Fund's needs were in a medium-term context. In addition, he could not approve of the Fund entering the business of subletting space.

It was not clear from the staff paper what the feasibility study would cover, Mr. Kabbaj continued. However, it appeared that the Fund would build a new Church and give it to the Board of Trustees of the existing Church. That, too, was not a Fund activity, and it could lead to problems concerning where the Fund's responsibility ended. The staff paper indicated that there had been problems in the past with the existing Board of Trustees of the Church. Therefore, was it worthwhile for the Fund to launch an operation that would probably take five to ten years? Furthermore, unreasonable demands could later be made by a future Board of Trustees. For example, the World Bank had had to agree to return the H-Building to the George Washington University after 40 years for the nominal cost of the land. Perhaps it was an appropriate time to consider the alternative, which had many advantages, of transferring the Fund to the suburbs.

Mr. Sugita noted that he was disappointed by the simple extrapolations in the staff paper regarding the space needs of the Fund. What he had in mind when he had suggested the discussion on leasing additional space was a more in-depth study that developed the long-term manpower needs of the Fund. In that sense, he supported Mrs. Walker's position. The present issue was a matter of insurance against a contingency. He was not convinced that the insurance premium was cheap enough. He could not support the proposed decision.

Mr. Almeida said that he had no problem with making a feasibility study to acquire the Church property. Furthermore, if the Fund's costs were reduced by subletting, he saw no problem with trying to obtain the additional leased space at present.

Mr. Parmena said that he supported the second part of the decision; however, the Board needed to consider the leasing of additional space more carefully at a later date.

Mr. Grosche remarked that he had become skeptical about leasing additional office space at the present time. It was his hope that the Fund would grow more slowly in future; consequently, it might be possible to stretch the existing space. In that way, it would be possible to put off the leasing of additional space until after the Church had been removed from its current site.

Mrs. Walker stated that the Board had obviously not arrived at a consensus.

Mrs. Filardo said that she was in agreement with Mrs. Walker.

The Acting Chairman said that the real issue--the future manpower needs of the Fund and its various prospective activities--was an abstract one. To take a fully informed decision on the need for additional space, it would be necessary over the coming year for the Board to assess the discussions on the role of the Fund and the impact on the size of the institution. Meanwhile, it would make sense to go forward with the feasibility study on the acquisition of the Church property.

The Executive Board then took the following decision:

Management is authorized to undertake the feasibility study related to the acquisition of the Western Presbyterian Church property, as outlined in EBAP/87/61, Supplement 1. The FY 1988 Administrative Budget will be augmented by the amount of $150,000 to cover the estimated cost of the study.

Adopted June 5, 1987

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/82 (6/3/87) and EBM/87/83 (6/5/87).

4. ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS, 1987 - PART ONE

The Executive Board approves Part One of the 1987 Annual Report on Exchange Arrangements and Exchange Restrictions, together with a letter transmitting the Report to the Board of Governors and the members of the Fund. (SM/87/90, Rev. 1, 5/21/87)

Adopted June 3, 1987

5. STAFF RETIREMENT PLAN - AGREEMENT WITH SWITZERLAND - EXEMPTION FROM ANTICIPATORY TAX

1. The Fund notes that the authorities of Switzerland are prepared to conclude an agreement with the Fund in order to exempt investment income of the Staff Retirement Plan in Switzerland from the Federal anticipatory tax.

2. The Managing Director is authorized to proceed with an exchange of notes between the Fund, as Employer and Trustee under the Staff Retirement Plan, and Switzerland, as shown in the attachment to EBAP/87/119 (5/27/87).

Decision No. 8605-(87/83), adopted
June 3, 1987

6. EXECUTIVE DIRECTORS' OFFICES - TEMPORARY STAFFING

The Executive Board approves the recommendation of the Committee on Executive Board Administrative Matters regarding the request for a temporary additional Advisor to Executive Director. (EBAP/87/123, 5/29/87)

Adopted June 3, 1987

7. EXECUTIVE BOARD TRAVEL

Travel by Advisors to Executive Directors as set forth in EBAP/87/126 (6/3/87) and EBAP/87/110, Supplement 1 (6/2/87), and by an Assistant to Executive Director as set forth in EBAP/87/125 (6/2/87) is approved.

APPROVED: December 15, 1987

LEO VAN HOUTVEN
Secretary