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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/140

10:00 a.m., November 13, 1981

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

Executive Directors	Alternate Executive Directors
	O. Kabbaj
	E. M. Ainley, Temporary
	J. F. Williams, Temporary
A. Buira	M. A. Senior
	H. G. Schneider
R. D. Erb	
M. Finaish	T. Alhaimus
	A. Nagashima
J. C. Iarezza	R. T. Salazar
	M. Casey
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
	F. Sangare
G. Laske	G. Winkelmann
G. Lovato	C. P. Caranicas
	A. Le Lorier
	A. Alfidja
	D. L. Kannangara
Y. A. Nimatallah	
J. J. Polak	
A. R. G. Prowse	
	L. Vidvei
	Wang E., Temporary

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

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Also Present
African Department: D. E. Syvrud. Central Banking Department: S. P. Leite. European Department: H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; J. Berengaut, M. Guitian, B. Nowzad, P. J. Quirk, T. M. Reichmann. External Relations Department: L. R. Azocar, H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: W. E. Holder, Ph. Lachman. Research Department: C. F. Schwartz, Associate Director and Director of Adjustment Studies; K.-Y Chu, L. U. Ecevit, N. M. Kaibni, T. K. Morrison, P. Radhakrishnan, P. C. Ugolini. Secretary's Department: A. P. Bhagwat, L. Collier, J. A. Kay. Treasurer's Department: A. M. Al-Samarrie, M. N. Bhuiyan. Western Hemisphere Department: E. W. Robichek, Director; S. T. Beza, Deputy Director; C. E. Sansón, Deputy Director; E. O. Bell, M. Caiola, L. A. Cardemil, R. A. Elson, A. M. Jul, J. P. Lipsky, P. Molajoni, H. J. O. Struckmeyer, S. Umana, J. F. van Houten, E. S. Williams, E. V. Zayas. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. E. Conrado, G. Jauregui, P. D. Peroz, F. Yeo T. Y. Assistants to Executive Directors: H. Alaoui-Abdallaoui, L. Barbone, M. J. Callaghan, R. J. J. Costa, M. K. Diallo, J. L. Feito, A. Halevi, Jiang H., J. M. Jones, P. Kohnert, J. E. Leimone, J. S. Mair, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. G. Pedersen, J. Reddy, J. Schuijer, H. Suzuki, O. Üçer, A. A. Yousef.

1. ANTIGUA AND BARBUDA - MEMBERSHIP - DRAFT RESOLUTION

The Executive Directors considered the report by the Committee on Membership for Antigua and Barbuda, together with a draft Resolution on membership for Antigua and Barbuda (EBD/81/285, 11/3/81).

Without discussion, the proposed decision was approved.

The decision was:

1. The Board of Governors is requested to vote without meeting pursuant to Section 13 of the By-Laws of the Fund upon the attached draft Resolution.

2. The Secretary is directed to send the attached report and draft Resolution on membership for Antigua and Barbuda to each member of the Fund by rapid means of communication on or before Monday, November 16, 1981.

3. To be valid, votes must be cast by Governors or Alternate Governors and must be received at the seat of the Fund on or before 6:00 p.m. Washington time, Wednesday, December 16, 1981. Votes received after that date will not be counted.

4. The effective date of the Resolution of the Board of Governors shall be the last day allowed for voting.

5. All votes cast pursuant to this decision shall be held in the custody of the Secretary until counted, and all proceedings with respect thereto shall be confidential until the Executive Board determines the result of the vote.

6. The Secretary is authorized to take such further action as he shall deem appropriate in order to carry out the purposes of this decision.

Decision No. 6980-(81/140), adopted
November 13, 1981

RESOLUTION

MEMBERSHIP FOR ANTIGUA AND BARBUDA

WHEREAS, Antigua and Barbuda on February 2, 1981 requested admission to membership in the International Monetary Fund in accordance with Section 2 of Article II of the Articles of Agreement of the Fund;

WHEREAS, pursuant to Section 21 of the By-Laws of the Fund, the Executive Board has consulted with the representative of Antigua and Barbuda and has agreed upon the terms and conditions which, in the opinion of the Executive Board, the Board of Governors may wish to prescribe for admitting Antigua and Barbuda to membership in the Fund;

NOW, THEREFORE, the Board of Governors, having considered the recommendations of the Executive Board, hereby resolves that the terms and conditions upon which Antigua and Barbuda shall be admitted to membership in the Fund shall be as follows:

1. Definitions: As used in this Resolution:

   (a) The term "Fund" means the International Monetary Fund;

   (b) The term "Articles" means the Articles of Agreement of the International Monetary Fund, as amended;

   (c) The term "SDR" means the special drawing right.

2. Quota: The quota of Antigua and Barbuda shall be SDR 3.6 million.

3. Payment of Subscription: The subscription of Antigua and Barbuda shall be equal to its quota. Antigua and Barbuda shall pay 18.75 per cent of its subscription in SDRs or in the currencies of other members selected by the Managing Director from those currencies that the Fund would receive in accordance with the operational budget in effect at the time of payment. The balance of the subscription shall be paid in the currency of Antigua and Barbuda.

4. Timing of Payment of Subscription: Antigua and Barbuda shall pay its subscription within six months after accepting membership in the Fund.

5. Exchange Transactions with the Fund and Remuneration: Antigua and Barbuda may not engage in transactions under Article V, Section 3, or receive remuneration under Article V, Section 9, until its subscription has been paid in full.

6. Exchange Arrangements: Within 30 days after accepting membership in the Fund, Antigua and Barbuda shall notify the Fund of the exchange arrangements it intends to apply in fulfillment of its obligations under Article IV, Section 1 of the Articles.

7. Representation and Information: Before accepting membership in the Fund, Antigua and Barbuda shall represent to the Fund that it has taken all action necessary to sign and deposit the Instrument of Acceptance and sign the Articles as contemplated by paragraph 8(a) and 8(b) of this Resolution, and Antigua and Barbuda shall furnish to the Fund such information in respect of such action as the Fund may request.

8. Effective Date of Membership: After the Fund shall have informed the Government of the United States of America that Antigua and Barbuda has complied with the conditions set forth in paragraph 7 of this Resolution, Antigua and Barbuda shall become a member of the Fund on the date when Antigua and Barbuda shall have complied with the following requirements:

   (a) Antigua and Barbuda shall deposit with the Government of the United States of America an instrument stating that it accepts in accordance with its law the Articles and all the terms and conditions prescribed in this Resolution, and that it has taken all steps necessary to enable it to carry out all its obligations under the Articles and this Resolution; and

   (b) Antigua and Barbuda shall sign the original copy of the Articles held in the Archives of the Government of the United States of America.

9. Period for Acceptance of Membership: Antigua and Barbuda may accept membership in the Fund pursuant to this Resolution not later than six months after the effective date of this Resolution, which date shall be the date of its adoption by the Board Governors; provided, however, that, if the circumstances of Antigua and Barbuda are deemed by the Executive Board to warrant an extension of the period during which Antigua and Barbuda may accept membership pursuant to this Resolution, the Executive Board may extend such period until such later date as it may determine.

2. GUATEMALA - STAND-BY ARRANGEMENT; EXCHANGE SYSTEM; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered requests from Guatemala for a stand-by arrangement for a period of one year in an amount equivalent to SDR 19.1 million (EBS/81/213, 10/23/81) and for a purchase equivalent to SDR 76.5 million under the Decision on Compensatory Financing of Export Fluctuations (EBS/81/212, 10/21/81; and Sup. 1, 11/6/81). They also had before them a report on the exchange system of Guatemala (EBS/81/202, 10/9/81).

The staff representative from the Research Department commented that there had been two developments since the issuance of EBS/81/212 which had a bearing on the calculation of the export shortfall. The first one had to do with nickel, the exports of which were included in the figures for "other exports." The authorities had very recently confirmed that, contrary to earlier expectations, the foreign-owned nickel mining company had decided that, because of the weak world demand for nickel, it would not resume its mining operations in Guatemala in the early part of 1982. On the basis of earlier information provided by the authorities at the time of the request, the staff had assumed that the suspension of nickel exports, which had begun in the second half of 1980, would be lifted in early 1982 and, accordingly, it had projected in EBS/81/212 a recovery in earnings from nickel exports. If, as was now expected to be the case, the suspension remained in effect during the entire postshortfall period, the projected earnings from "other exports" and from total exports would be reduced by SDR 13 million in 1981/82 and by SDR 41 million in 1982/83. The second development was the recent price decision taken by OPEC to lower petroleum prices. In the light of that decision, the staff had reduced somewhat the price projection for Guatemala's petroleum exports. The effect of the lower price now projected was to reduce anticipated earnings from petroleum exports by SDR 1 million in 1981/82 and by SDR 9 million in 1982/83. The total effect of the two developments was to reduce the export shortfall from the initial estimate of SDR 93 million to SDR 83 million, which was of course still larger than the proposed purchase of SDR 76.5 million.

Mr. Buira made the following statement:

I would like to express the appreciation of my Guatemalan authorities for the excellent work done by the recent Fund mission and the prompt response to their request for a stand-by arrangement in the first credit tranche as well as the use of the Fund's resources under the compensatory financing facility.

My authorities are in broad agreement with the thrust of the staff papers regarding recent developments in the economy and its prospects for the near future. They would only suggest a slight difference in emphasis concerning the various factors that have given rise to the present situation. In this regard, it would seem to my authorities that exogenous factors have had a greater impact on the external accounts than the moderately expansionary policies that they have had to implement in order to sustain a certain level of economic activity in difficult circumstances of economic and social instability.

After the coffee boom of 1976-77, the economic and financial situation of Guatemala deteriorated significantly due to a negative combination of both external and internal factors. The growth of real GDP, which had averaged 7.5 per cent a year in 1976-77, declined to 3.5 per cent in 1980 and is projected to drop further, to 1 per cent, in 1981. This deterioration, however, can only be analyzed in its proper perspective if seen in the context of developments in the world economy and in Central America during the last three years.

It is necessary to recall that over the last three years the world economic situation has been characterized as bleak, with the prevalence of high rates of inflation, low or negative rates of economic growth in industrial countries, and large external imbalances in many countries, particularly in oil importing countries. In addition, the expansion of world trade has fallen to very low rates, protectionist tendencies have intensified, and interest rates have reached very high levels. These factors have resulted in a severe worsening in the terms of trade of oil importing developing countries, markedly reducing their purchasing power and exacerbating their financing problems.

The situation of the Central American countries has been further aggravated by rising political uncertainties and mounting social tensions in the region. These trends have contributed to an erosion of private sector confidence, a slack in private investment, massive flight of capital, and the virtual interruption of these countries' access to international capital markets. In such circumstances, and in marked contrast to their traditional conservative policy stance, the authorities of Guatemala found it necessary to implement compensatory fiscal and monetary policies in an effort to maintain economic activity, safeguard a required minimum of employment, and preserve a degree of social stability, itself a precondition for economic growth.

The worsening of the external payments position reflects the weakening of the demand for Guatemala's exports, with the price of coffee, the country's largest source of export earnings, falling in 1981 to its lowest level in five years. On the other hand, the prices of imports, especially oil, increased substantially; and receipts from travel suffered a reduction to less than half their normal levels. Consequently, the terms of trade deteriorated quite markedly; export prices declined by 2.6 per cent in 1978 and increased by only 3.0 per cent in 1979 and 12.4 per cent in 1980, while import prices increased sharply, by 10.2, 16.6, and 20.3 per cent, respectively, in the same years, increasing the external deficit on current account from the equivalent of 1 per cent of GDP in 1976-77 to 3.5 per cent of GDP in 1978-79. For 1981, the current account deficit is projected to increase to 6 per cent of GDP. Since 1979, political uncertainties resulted in large private capital outflows and made it increasingly difficult for Guatemala to preserve its access to international financial markets. As the pressure of net capital outflows intensified, the overall balance of payments deficit rose from 0.4 per cent of GDP in 1979 to 4.1 per cent in 1980. Thus, the net international reserves of the Banco de Guatemala declined from $744 million at the end of 1978, equivalent to about 6.4 months of imports, to $219 million by the end of August 1981, a figure equivalent to only about 2 months of imports.

Faced with such a deteriorating international and regional economic environment by late 1979, the authorities felt that it was necessary to modify their traditionally conservative fiscal policy stance, with the dual purpose of helping sustain economic activity and of improving social services and basic infrastructure, especially in the rural areas. The change in policy, which was felt to be necessary on economic grounds, was also considered timely in a broader perspective--namely, as a contribution to social stability, a precondition for investment and growth. As a result, the overall budget deficit increased from the equivalent of 1.1 per cent of GDP in 1978 to 2.6 per cent in 1979 and 4.7 per cent in 1980. While this deterioration reflects increases in expenditures, particularly in investment, it is also a consequence of important reductions in tax revenues as a proportion of GDP due to the overall deceleration in economic activity and the sharp decreases experienced in the prices of important export commodities, especially coffee.

Faced with a weakening external and reserve position, the authorities have drawn their reserve tranche in the Fund and have requested a stand-by arrangement in support of their financial program for 1981/82 and a purchase under the compensatory financing facility. The financial program is well balanced and would seem to go beyond what is usual for a first credit tranche drawing. Its basic objectives are to limit the loss of net international reserves and to strengthen the country's external position through a combination of fiscal, monetary, and external debt policies.

With regard to monetary policy, interest rates are being made flexible, and important increases were introduced last month. In the fiscal area, expenditures will be reduced and tax administration will be improved, in order to significantly reduce the Central Government's overall deficit. At the same time, the authorities will increase the recourse to foreign borrowing to finance a larger share of the investment program in order to alleviate pressures on the need for central bank credit expansion. The combination of these policies should facilitate a reduction in the rate of increase of the net domestic assets of the Banco de Guatemala, thereby strengthening its reserve position.

The request for a purchase under the compensatory financing facility is also clearly justified, for the reasons explained in the excellent staff paper. The balance of payments need of Guatemala justifies the drawing; and the continued cooperation with the Fund has been amply reinforced by the stand-by arrangement under consideration. The estimated shortfall in exports amply exceeds the requested drawing (by 22 per cent). The overall decline in merchandise exports and the sharp fall of 51 per cent in travel receipts are clearly attributable to circumstances largely beyond the control of the authorities. The temporary character of the shortfall is evidenced by the trend estimated by the staff. Thus, all the conditions required by the decision for a drawing under the compensatory financing facility have been met.

Mr. Salazar stated that he had no difficulty in accepting Guatemala's requests for a stand-by arrangement and a purchase under the compensatory financing facility, and he endorsed the program that had been adopted in support of the stand-by arrangement. The economic and financial difficulties facing Guatemala had been caused partly by factors beyond the control of the authorities, such as the adverse swing in the terms of trade, and partly by the effects of the expansionary fiscal policy. The main objective of the stabilization program begun October 1981 was to reduce the loss of net official reserves through the use of a combination of monetary and fiscal policies. The recent increase in the ceilings on bank loans and deposit interest rates, and the intention of the authorities to make the interest rate policy even more flexible were certainly welcome. Further interest rate adjustments were needed because of the expected domestic inflation and the high interest rates abroad, and in recognition of the risk component of investment in Central America.

The financial savings of the private sector were projected to rise at a rate of 13 per cent in 1981 and 14.5 per cent in 1982, Mr. Salazar noted. Did the staff feel that those rates had become more attainable after the recent adjustments in interest rates? Might additional adjustments be needed in the near future to ensure that the financial targets were met?

The emphasis in the past on public expenditure for countercyclical purposes had been justified in the special circumstances of Guatemala, but it could not be maintained for long because of the burden it placed on the external current account, Mr. Salazar remarked. The intention of the authorities to reduce the size of the overall budget deficit by curbing expenditures and increasing the efficiency of the tax system was therefore welcome. The authorities had wisely decided to keep government expenditure at the equivalent of 13.1 per cent of GDP in 1982, but the burden of the adjustment effort would fall on public investment. Since many of the problems facing the economy stemmed from structural bottlenecks, such as those in the energy and transportation sectors, a significant curtailment of public investment could have adverse effects on the economy in general, and on the balance of payments position in particular. Did the staff feel that there was room for a different mix of current and capital expenditures?

The poor performance of public savings in recent years, Mr. Salazar commented, was due in part to the reliance on coffee export tax revenues--which fluctuated with the price of coffee in international markets--and in part to the general inelasticity of the tax structure. The domestic sales tax rate had recently been increased, but additional measures to improve budgetary income might well be needed to finance the projected public investments, and the intention of the authorities to strengthen the tax audit procedures to reduce the level of tax evasion was welcome. Externally, the authorities should be encouraged to reduce their reliance on exchange controls and other constraints on capital transactions, and to increase their reliance on a realistic interest rate policy as part of the effort to restore the level of international reserves.

Mr. Erb considered that the interest rate and fiscal measures in support of the stand-by arrangement constituted an initial step in the direction of improving the balance of payments position and stabilizing the Guatemalan economy. As the staff had concluded, if a sustainable balance of payments position was to be achieved in the medium run, additional revenue measures would have to be adopted to reduce further the budget deficit and to eliminate the increasing reliance on foreign borrowing to finance investment expenditures. It would be useful to have the staff's assessment of the likelihood that the authorities would receive the additional amount of external capital provided for in the financing program for 1982. If the expected amount did not materialize, what additional measures did the authorities intend to introduce?

In the light of the pressure on Guatemala's reserve position, Mr. Erb continued, the recent increase in domestic interest rates should make an important contribution to reducing the incentives for short-term capital outflows. However, in the coming period the authorities presumably would have to keep domestic interest rates at a level that would prevent any negative differential vis-à-vis international interest rates and, in that connection, the authorities should perhaps explore the possibility of introducing a scheme under which domestic interest rates could be adjusted to developments abroad automatically. Finally, Guatemala's request to use the compensatory financing facility was one of a series of recent requests necessitated by quota limitations under the International Coffee Agreement which had contributed to a member's calculated shortfall. He wondered whether it would not have been more appropriate to encourage Guatemala to use the buffer stock financing facility rather than the compensatory financing facility.

Mr. Gabriel-Peña stated that the proposed decisions were acceptable. In the period 1976-78, the economy had grown at an average rate of 6.7 per cent a year, the level of reserves had been the equivalent of more than six months of imports, and the overall fiscal deficit had been held to the equivalent of about 1.5 per cent of GDP. In the period 1979-81, however, it had been estimated that the rate of real economic growth had fallen to 1 per cent, international reserves had dropped to approximately 2.5 months of imports, and the overall fiscal deficit had risen to 4.5 per cent of GDP. The proposed stand-by arrangement, which amply met the cooperation criterion under the compensatory financing facility, should restore a moderate rate of economic growth.

Curbing central bank financing of the fiscal deficit was a key element of the new program, Mr. Gabriel-Peña noted; it should help Guatemala to maintain its relatively good inflation record. The authorities had decided to close the financing gap by reducing expenditures and by combining higher taxes and interest rates with additional foreign borrowing. The increased interest rates would probably play an important role in curbing capital outflows and in providing incentives for capital inflows.

He hoped that the commercial banks would respond favorably to what would be Guatemala's initial approach to the international capital markets, Mr. Gabriel-Peña went on, especially as the country's ratio of foreign debt to GDP of 7 per cent was one of the lowest in Latin America. Guatemala clearly had to restore an adequate level of domestic investment, and the drawing under the compensatory financing facility would provide the foreign exchange needed for imports, thereby preventing a further reduction in the rate of growth. He agreed with the staff that the shortfall in Guatemala's principal exports was temporary in nature and had been caused by factors largely beyond the control of the authorities. The staff's projections for the volume and price of Guatemala's coffee exports were fully consistent with present international trends and with the international arrangements affecting coffee. In passing, he said that international agreements tended to stabilize export earnings; they were in no way responsible for the fluctuations in the prices of primary products in world markets.

Guatemala's shortfall in cotton exports was due entirely to failure to produce enough, Mr. Gabriel-Peña continued, and the steps that the authorities had taken to reduce the cost of production, thereby restoring a larger volume of cotton exports, were encouraging. Two other major export products--sugar and bananas--had been providing a cushion during the shortfall year, but the projected international prices for those products in the first postshortfall year probably would not be favorable. As for Guatemala's traditional minor export commodities, the proceeds from exports of petroleum were expected to increase fourfold in 1982 and to double again in 1983; that development would certainly help to increase the value of total exports.

The proposed requests were timely, Mr. Gabriel-Peña considered. The winding down of government outlays for the hydroelectric and Pacific seaport projects in 1982 should coincide with the recovery of exports in 1982-83 which, together with the expected foreign capital inflow, should result both in a sustainable balance of payments position and in the resumption by the authorities of badly needed investment in roads, housing, and petroleum exploration.

Mr. Winkelmann said that he could accept both draft decisions. The staff had clearly shown that, during the previous three and one-half years, the economic and financial situation had deteriorated as a result of adverse changes in the terms of trade, erosion of private sector confidence, and expansionary monetary and fiscal policies. Mr. Buira had suggested that the Government had compensated for the loss of revenue from the external economy by encouraging expansion of demand in the domestic economy; for political and social reasons, the authorities had wished to contribute to domestic economic stability and confidence, in part to boost private investment. However, he did not agree with Mr. Buira that the authorities' economic policies had been merely "moderately expansionary." After all, the budget deficit had risen from the equivalent of 2.5 per cent of GDP in 1979 to 4.5 per cent in 1980; and, while more than one third of the deficit in 1979 had been financed by the Bank of Guatemala, the share had risen to nearly two thirds in 1980. The authorities were attempting to tighten monetary and fiscal policy by cutting the budget deficit, thereby reducing the amount that the Government would have to finance; the expenditure cuts in the investment program had been particularly important.

Although the demand for investment was expected to decline with the completion of work on the hydroelectric and other infrastructural projects, Mr. Winkelmann continued, the domestic savings rate still seemed to be rather low. It had fallen from 19.4 per cent in 1977 to an estimated 11 per cent in 1981, although it was projected to increase somewhat in 1982. It would be useful to know what the potential domestic savings rate had been in recent years, and whether the decline in the actual rate of savings had been due to the performance of private savings or government savings. If there had been a decline in government revenues, the authorities would probably have to strengthen the revenue performance as well as continue to cut expenditures. The authorities apparently had already had considerable success in restructuring government revenues to lessen the reliance on revenues from coffee and to increase revenues from excise taxes, but further steps seemed to be needed. What was the potential savings rate for the economy in the medium term? External savings were expected to increase dramatically in 1981 but to fall in 1982. Had external savings been used to finance consumption rather than investment?

Exchange rate policy could probably play a useful role in the stabilization effort of Guatemala, especially in view of the recent restoration of confidence in the economy, Mr. Winkelmann commented. In the circumstances, elimination of the remaining exchange restrictions would probably encourage capital inflows and permit the exchange rate to play a greater role than hitherto in stabilizing the economy.

Mr. Kharmawan stated that he accepted the draft decisions. The authorities had adopted countercyclical measures to spur economic growth, which had reached 7.5 per cent in 1976-77 but had fallen to 3.5 per cent in 1980 and an estimated 1.0 per cent in 1981. Did the staff feel that the decline in the rate of economic growth would have been even steeper in the absence of the countercyclical measures, or that another policy response would have been more appropriate? The authorities' expansionary policies seemed to have intensified the pressure on the balance of payments. Finally, what impact was the new financial program expected to have on the rate of economic growth in Guatemala in the coming period?

The staff representative from the Western Hemisphere Department commented that the staff had made allowance for the effect of the interest rate adjustment on the growth of liabilities of the private sector in both 1980 and 1981. The assumption was that, at least during the period of the new financial program--mainly in 1982--the differential between domestic and foreign interest rates would be nearly eliminated; therefore, it was clear that, if interest rates prevailing abroad continued at a high level, the adjustments that the Guatemalan authorities had made thus far would be insufficient, and further adjustments could be expected. However, there had recently been some softening in foreign interest rates, and the question of the appropriate level of interest rates in Guatemala was to be kept under continuous review by the authorities. Another factor that could have an effect on confidence, as reflected in the rate of growth of liabilities of the private sector in 1982, was the outcome of the elections scheduled for early March 1982.

Commenting on public expenditure in Guatemala, the staff representative said that in the budget proposal that had recently been presented to the Congress, the compression of current spending was slightly greater than had been expected. The net result had been a more favorable mix of capital and current spending. In addition, the basic line of development in the public investment program in 1980-81 would be continued through 1982, although the rate of expenditure on some of the major projects would be decelerated somewhat. Hence, there would be an essential continuity in public sector spending, even though the total volume would be somewhat smaller than had been originally anticipated. In the period of the new economic and financial program, the Government was expected to continue to emphasize the need to increase the level of private investment activity.

The budget documents showed that the authorities expected to increase their level of commercial borrowing by about $50 million in 1981; that amount was over and above lines of credit that would be used from international development agencies. The authorities were in the process of testing the market for their entry into it; they expected a positive reception and, in that connection, approval of the proposed stand-by arrangement would probably be helpful. In the absence of a foreign placement of bonds by Guatemala, the authorities probably would have to contract spending even further. They did not plan to introduce any new revenue measures through the end of the term of the present Government, but such measures could be among the options available to the new Government.

The question had been raised, the staff representative recalled, whether more automaticity could not be introduced into the setting of domestic interest rates. The ceilings on loan and deposit rates had been raised, but there had not been a corresponding response in the market, partly because of the nature of the domestic banking system, which was cartelized. The authorities planned to influence the setting of interest rates more directly than hitherto; if necessary, they would engage in open market operations to force interest rates up to appropriate levels.

The staff felt, the staff representative continued, that the decline in the rate of savings in Guatemala had been reflected most prominently in the savings of the private sector, mainly because of the fall in income generated in the export sector following the deterioration in the terms of trade, and because of the flight of capital, which had been particularly strong in 1979 and 1980. The decline in savings had been reflected in the fall in domestic private investment, but there had also clearly been a reduction in goverment savings, of about 2 percentage points, during the previous four years. The potential savings rate for the economy was probably about 17 per cent, assuming that the sustainable current account deficit for Guatemala in the coming two or three years was equivalent to approximately 3 per cent of GDP, down from 6 per cent in 1981.

The authorities did not wish to exercise the option of using the exchange rate policy instrument at the present stage, the staff representative explained. They felt that the factors that had damaged the external position had been primarily exogenous in nature. They recognized the contribution that domestic financial policies could make to the stabilization effort, and they believed that, given the medium-term prospects for the balance of payments, the present exchange rate was viable.

The decline in the rate of economic growth in recent years would probably have been sharper in the absence of the countercyclical policies--especially in the fiscal area--that the authorities had introduced, the staff representative from the Western Hemisphere Department considered. There had clearly been a shift in the structure of investment in Guatemala in the past two years; the private sector had previously accounted for the bulk of investment activity. As to the appropriate policy mix for Guatemala, the staff had concluded in its report for the 1980 Article IV consultation with Guatemala that there had been grounds for maintaining an expansionary fiscal policy. The staff had noted the dampening effect on economic growth of the decline in private sector confidence, but it had favored a tighter monetary policy than the authorities had been maintaining, particularly in the light of the rigid structure of domestic interest rates and the authorities' reliance on financing by the central bank, a problem that had been directly addressed in the new economic and financial program.

The staff representative from the Research Department recalled that the question had been asked whether it would not have been more appropriate for Guatemala to have requested a drawing under the buffer stock financing facility than under the compensatory financing facility, in view of the country's participation in the International Coffee Agreement. Participants in that agreement did not qualify to draw under the buffer stock financing facility because the agreement itself provided for stabilization exclusively by way of export quotas; it did not rely on the accumulation and reduction of stocks by means of an internationally agreed buffer stock, unlike some other existing commodity agreements, such as those for sugar, cocoa, rubber, and tin. A proposal had been made to introduce a buffer stock mechanism in addition to the export quota system that had been in operation under coffee agreements to date, but that proposal would only be examined in the context of the forthcoming negotiations on renewal of the present agreement, which was due to expire in September 1982. Under the agreement concerning sugar, Guatemala was in the process of accumulating stocks, as required in connection with the agreement's stabilization operations, and it was possible that Guatemala, as well as other participants in the agreement, might soon qualify to draw under the buffer stock financing facility.

The Chairman commented that increasing private savings was a fundamental aspect of the new financial program. The staff representative from the Western Hemisphere Department had mentioned that the savings ratio had been declining because of a number of factors, such as the deterioration in the terms of trade and the fall in the revenues of domestic producers. Did the staff feel that, in coming years, the revenues of producers in general, and of exporters in particular, would be sufficient to boost private savings to the full potential of the country? In the absence of a recovery in exports, it would probably be quite difficult for Guatemala to achieve a savings rate of the order of 17 per cent of GDP, in which event monetary policy would become particularly important.

The staff representative from the Western Hemisphere Department responded that the projections underlying Guatemala's requests for a stand-by arrangement and a purchase under the compensatory financing facility were based on the assumption that there would be a strong recovery of export growth in the coming two years which, under normal conditions, would yield a strong boost in domestic savings. In that connection, the domestic and regional political situation was an important, but uncertain, factor. The potential for achieving a recovery in domestic private savings clearly existed in Guatemala, and the authorities' continued efforts to restore competitiveness in the domestic interest rate structure should make a significant contribution. In the final analysis, however, the outcome with respect to private domestic savings would probably be determined by noneconomic factors.

Mr. Erb considered that the staff should examine possible appropriate approaches by the Fund to the problems that arose when political developments in one or two countries in a region--such as Central America and Eastern Europe in recent years--adversely affected the flow of private capital into other countries in the region, thereby worsening the economic situation there.

The Chairman recalled that during the 1981 Annual Meeting a number of Governors for Central American countries had asked him whether the Fund could tackle the problems caused by the uncertain flow of capital in their region. The matter should be the subject of a study by the staff.

The Executive Board then turned to the proposed decisions, which were approved.

The decisions were:

Stand-By Arrangement

1. The Government of Guatemala has requested a stand-by arrangement for the period of one year from November 13, 1981 for an amount equivalent to SDR 19.1 million.

2. The Fund approves the stand-by arrangement set forth in EBS/81/213, Supplement 1.

Decision No. 6981-(81/140), adopted
November 13, 1981

Exchange System

Effective September 14, 1981 Guatemala intensified the restriction on purchases of foreign exchange for certain types of travel abroad, as described in EBS/81/202. The Fund notes the intention of the Guatemalan authorities to remove this restriction as soon as possible, and in the circumstances of Guatemala grants approval for the retention of this restriction until the completion of the next Article IV consultation, or December 31, 1982, whichever is earlier.

Decision No. 6982-(81/140), adopted
November 13, 1981

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Guatemala for a purchase of SDR 76.5 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224(79/135), adopted August 2, 1979).

2. The Fund approves the purchase in accordance with the request.

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

Decision No. 6983-(81/140), adopted
November 13, 1981

3. BRAZIL - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Brazil (SM/81/205, 10/28/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in Brazil (SM/81/207, 11/3/81).

Mr. Kafka made the following statement:

I should like to thank the staff for their excellent papers. The Brazilian authorities are in broad agreement with the views expressed by the staff. More important, perhaps, they have again appreciated and benefited from the completely frank discussions on past policies and future plans with an outstanding team of objective technicians which these periodic consultations afford them.

There is no question that there has been a basic turnaround in Brazil's economy in 1981. The obstinate trade deficit that plagued us throughout the 1970s and that has been uncomfortably large since 1973, except in 1977, has given place to a surplus, which continues to increase. The current account deficit is declining substantially in real terms as well as in nominal terms. Inflation, while still very high, has peaked and is declining.

These results are the consequence of the policies adopted since late 1980. What is impressive is that they have had such a quick effect on Brazil's situation, despite a steadily deteriorating world economy and despite the interest shock that has been particularly damaging to Brazil. These policies have permitted Brazil--as we foresaw at the time of our 1980 Board discussion--less than a year after the end of the second oil shock, to make remarkable progress in its adjustment process during the current year.

These favorable results have certainly not been costless, but their burden has been tolerable and, in fact, less than was expected. The Brazilian authorities propose not only to adhere firmly to, but to strengthen, the present policy stance, as it is producing the desired adjustment.

There is very little to add to the excellent description given by the staff of economic developments during 1980 and 1981 to date. The general stance of the policies pursued in 1981 and to be pursued in 1982 is equally well described by the staff, including the priority accorded to reducing the current account deficit and inflation, and to improving the efficiency and the allocation of resources. The Brazilian authorities are fully aware that these objectives could not be attained without a temporary slowdown in the rate of growth. But they are confident that the slowdown will be relatively short. The rapid turnaround achieved in the external situation, the progress on inflation, and the first signs of a decline in unemployment all appear to bear them out. They have not retreated from their objective of improving income distribution, which they continue to pursue by various means. For both reasons they have felt fully justified in avoiding drastic cuts in investment projects under way, both those with a mainly social content and those that will be required when growth again approaches higher rates.

Demand Policies

A series of measures, in addition to those mentioned by the staff, have been adopted in order to strengthen fiscal control. Regarding the social security system, the Congress recently approved both a delay in the entitlement to medical benefits for new participants in the system and, as the staff mentions, an increase in the upper limit on income subject to social security contributions. It rejected both the proposed reduction of pensions payable to those taking employment after retirement and the reduction in the adjustment factor for minimum pensions. Instead, it authorized the Government to levy excises of up to 20 per cent on nonessentials. The definition of nonessentials is left to the Executive and is expected to cover a range of goods, possibly including gasoline. Further measures to improve the financial situation of the social security system continue to be under study.

The plan to sell to the private sector, or to close down, government enterprises is being pursued. In addition to a few minor enterprises, an important textile factory has just recently been sold to a private group. Further sales are expected before the end of the year.

A series of additional income tax changes have been approved. The tax credit for investments in supervised mutual funds has been reduced by 40 per cent. The deductibility from personal income of insurance premiums and of interest on personal loans has been eliminated. Beginning in 1983, the deductibility from income of purchases of certain financial assets will be reduced by 50 per cent. The deductibility from financial institutions' profits of reserves against dubious loans has been reduced from 3 per cent to 1.5 per cent.

The impact on the 1982 federal budget of the numerous tax changes, most of which will not only strengthen revenue but also improve post-tax income distribution, has not yet been established. The original budget bill foresaw both expenditures and revenues of approximately Cr$4,000 billion, i.e., nominal increases over the likely outturn for 1981 of 72.5 per cent. This would imply stability, or a decrease in real terms. However, revenues have probably been underestimated by Cr$300-400 billion to be transferred to the monetary budget, and the original expenditure estimates contained close to Cr$100 billion in transfers to the monetary budget. Thus, total such transfers will reach 12 per cent of the budget, considerably more than this year's 8 per cent. Other expenditures from the central budget will thus decline in real terms. Contributing to this result is a hiring freeze in the public sector.

The budgets for state enterprises will not include major new projects, except the Carajas Minerals Project, which will be financed from the surplus of the highly profitable state-owned Companhia Vale do Rio Doce and by its foreign and domestic shareholders and clients. A first meeting with representatives of foreign governments and firms took place in Paris in September, under the auspices of the World Bank. Two major hydroelectric works, Tucurui and Itaipu, will be implemented according to schedule; the former is linked to Carajas, the latter is essential for Southern Brazil and is expected to come on stream early in 1983. The execution of many other investment projects will be postponed or, alternatively, slowed down wherever possible, in view of financial costs already incurred.

The monetary budget for 1982 is about to be put in final shape. It is likely to foresee a limit of about 50 per cent for the growth of the monetary base. More important, perhaps, it is likely to foresee a limit of about two thirds for the increase in the credit of the monetary authorities. A limit of about 50 per cent is also foreseen also for loans by commercial and investment banks and finance companies, except those financed through foreign loans. These rates of credit expansion are again certain to fall short of the rate of inflation. No sizable recourse to net open market sales is foreseen.

The rate of inflation should decline to between 70 per cent and 80 per cent in 1982, which would considerably reduce the size of interest subsidies. Nevertheless, an increase in explicit interest rates for subsidized credits is under study. Credit subsidies this year already declined in real terms by one fourth compared with those which prevailed in 1980. Total subsidies declined from nearly 6 per cent of GDP in 1980 to 3 per cent in 1981.

The freeing of interest rates other than for subsidized credit has enabled the authorities to sell an unprecedented volume of treasury bills. Financial savings have also appeared to increase in other forms. It is likely that overall savings as a share of GDP have increased considerably, although the extent to which they have done so will be known only when the 1981 national accounts become available.

Supply Developments

Under the stimulus of support prices geared to the world market and adequate credit, as well as, so far, favorable weather conditions, planting for the new crop is proceeding apace, and the expectation is for another excellent crop.

Oil production has increased 20 per cent over 1980 and is expected to rise by one third in 1982, when it should cover close to 30 per cent of the net consumption of oil. A number of new wells have been discovered, and exploration is being further intensified both onshore and offshore. The fact that this year, for the first time, one of the international firms exploring for oil in Brazil under so-called risk contracts in nontraditional areas has discovered a well capable of producing commercial quantities is expected to encourage further exploration by the multinationals.

The electricity corporations are actively engaged in prompting the substitution of electricity for heating materials, both gas, of which Brazil produces little, and fuel oil. Price increases for petroleum products continue to encourage oil conversation and the use of substitutes for oil.

There have been some interesting developments on the labor front. There is increasing disillusionment with the present wage law, not only among employers but also among workers and trade union leaders. While no early change in the law appears to be in sight, the Government has just recently taken an important step by adjusting the minimum wage by 100 per cent of the cost of living increase rather than 100 per cent, as was the practice in the recent past. Trade unions are showing interest in employment stability rather than wage increases and are increasingly bargaining for a temporary stop to the dismissal of workers rather than for substantial so-called productivity bonuses above the mandatory cost-of-living adjustments. The dismissal of workers and hiring of new ones at lower wages, and slower promotions, reduce the impact on labor costs of the adjustment factors built into the wage law.

Some interesting facts have also become available on unemployment. Its level appears to have peaked in July and August, and to be declining. Like a recovery of industrial output, this is, of course, not surprising. It may be partly seasonal, but much of the fall in output and employment represented mainly an inventory recession. It should be remembered that industrial output had grown substantially in 1980, and had been reflected in large inventory accumulation in view of the controlled interest rates prevailing in that year. Some firms, particularly in the automobile industry, have found that 38 per cent of those dismissed appear to leave the city of their previous employment and return to their city or state of origin. They draw on their unemployment insurance fund and often establish small businesses in the places to which they return. As for the others, average unemployment for unskilled workers does not seem to exceed 19 weeks, and the periods for technicians and foremen are considerably shorter.

External Policies

The authorities are depreciating the cruzeiro in line with the rate of internal inflation and will continue to do so; formerly, of course, the rate of depreciation corresponded roughly to the inflation differential with the trading partners. This will continue to produce a real depreciation corresponding to the worldwide rate of inflation, which is, of course, by no means negligible. The containment of domestic demand policies has already proved to be a most effective promoter of exports. The maintenance of such a policy in 1982 can be securely expected to continue to promote the exportation of industrial products, despite the slow growth of the world economy. Brazil, after all, is still a small exporter in the world context.

The first estimates for the balance of payments in 1982 have now been prepared. They foresee a slightly more rapid rise in the value of exports than during 1981 (19 per cent as against 17.5 per cent). This is explained by the expectation that the prices of primary products will not again suffer the major falls they did in 1981, while the growth of manufactured exports will continue this year's trend (an increase of close to 30 per cent).

Imports, which stagnated in 1981 in view of the slowdown in growth and liquidation of inventories, are expected to rise 11 per cent in value, or perhaps 7 per cent in volume. This will permit some resumption of industrial growth in 1982. In these circumstances, Brazil expects a trade surplus of about US$3 billion in 1982, as against about US$1 billion this year. The surplus, for the year to date, is over US$600 million and rising steadily.

Net payments for services are expected to increase close to 15 per cent, to about US$13 billion. This is a deliberately pessimistic estimate, which assumes a rise in world market interest rates compared with the average for 1981. Under these conditions, the current account deficit should decline substantially further in terms of GDP as well as in nominal terms. Instead of reducing the volume of foreign borrowing from the current year, when it has been relatively high, Brazil expects to maintain it close to its 1981 level in order to add about US$1 billion to reserves.

> Altogether, I think that again, as during our 1980 discussion, an optimistic forecast appears justified. For reasons already given, the overall growth of the economy can confidently be expected to exceed this year's and to assure a sensible rate of per capita growth. The strengthening of fiscal policies and the maintenance of tight monetary policies will enable further progress to be made on inflation and on the current account. Given the demonstrated resilience and adaptability of the Brazilian economy, it would not be surprising if, by 1983, Brazil once again approached its historical long-term growth trend and, with it, further improved income distribution in the context of declining inflation and rising external reserves.

Mr. Iarezza commented that in December 1979 the Brazilian authorities had implemented a comprehensive package of measures in the exchange, trade, fiscal and monetary fields to cope with the persistent decline in reserves and a general weakening of the economy following the increase in the price of oil. The exchange rate had been devalued by 30 per cent, and the cruzeiro was to be adjusted in line with the projected rate of inflation. Monetary and fiscal policies had also been designed to restrain inflation, which had reached 50 per cent in 1980.

Unfortunately, Mr. Iarezza continued, the program introduced in 1979 had included certain features--particularly the ceiling on nominal interest rates, which was maintained until late 1980--that had reduced the likelihood of success. Interest rates had not been adapted to the rate of inflation, which was higher than had been expected because of the relaxation of price controls, the steady rise in oil import prices, and inflationary expectations. As interest rates became increasingly negative, a gap had developed between actual and desired money balances, thereby stimulating an accumulation of stocks and an increase in consumption expenditures. The authorities had been unable to restrain total aggregate expenditure; they had attempted to control the money supply alone, but had been unsuccessful because of the rise in velocity of the circulation of money. Brazil's overall balance of payments had weakened, the level of reserves had fallen, and the credibility of the exchange rate policy had been undermined; the cruzeiro had been persistently overvalued. Those developments had occurred despite a significant improvement in the control of the fiscal deficit, which had declined from the equivalent of 5 per cent of GDP to less than 3 per cent in 1980.

Since then, Mr. Iarezza went on, the authorities had displayed a welcome degree of pragmatism in adjusting their economic policies. They were committed to strengthening the balance of payments, reducing the rate of inflation, and improving economic efficiency and the allocation of resources, and there had been improvements in all those areas in the first nine months of 1981; indeed, the external position had improved substantially, and the rate of inflation had decelerated. Among the economic policy adjustments that had been made, the introduction of a more flexible interest rate on deposits and in the nonsubsidized credit sector was particularly welcome as it had stimulated private savings, thereby reducing the resource gap. The Brazilian authorities should be encouraged to extend their flexible interest rate policy to cover the subsidized credit sector, which was not covered by the monetary authorities' ceilings on credit expansion. Still, the ceilings were a particularly important element of a policy package that included a flexible exchange rate; the introduction of quarterly targets--and the inclusion of the Bank of Brazil in their coverage--was especially welcome.

He agreed with the staff, Mr. Iarezza said, that the present monetary policy probably relied excessively on open market operations, and that the authorities should be encouraged to maintain the efforts they had successfully begun in 1980 to control the public sector accounts. In that context, the recently introduced tax measures and the steps that were to be taken soon to reduce the number of state enterprises were fully appropriate.

He welcomed the removal of a number of price controls in 1980 and 1981, Mr. Iarezza remarked. The increase in the price of petroleum products had already resulted in a drop in the volume of oil imports. Price deregulation had also been extended to a wide range of agricultural commodities and to approximately one third of all industrial products. The authorities should be encouraged to continue to increase efficiency by gradually relaxing the remaining price controls and restrictions. Flexible prices and interest rates could play an important role in the stabilization effort by discouraging excess stock accumulation and reducing inflationary pressures.

As the staff had concluded, Mr. Iarezza noted, the practice of setting wages on the basis of past inflation might well preclude a gradual deceleration of prices and make the trend in real wages incompatible with the objective of achieving a high level of employment. The ongoing discussions in Brazil on possible ways of making wage laws more flexible were therefore particularly welcome, and the recent developments on the labor front that Mr. Kafka had mentioned in his opening statement were promising. The trade unions seemed more willing than hitherto to preserve employment levels rather than maintain an inflexible policy on nominal wages. Their attitude should make an important contribution to achieving price and wage flexibility; it constituted an important departure from the backward-looking mechanism of wage determination that had been used in the past.

Brazil's economic program was appropriate, Mr. Iarezza commented. It had already achieved positive results in the external economy, as reflected in the recent surplus in the trade account and the projected surpluses for all of 1981 and 1982. As for the external current account, it was important to remember that an increase in the level of a country's net interest payments on external debt was not necessarily an unfavorable reflection on a country's internal policies; it could be the result of the adjustment of the world economy to the counterinflation policies of the governments in the main financial centers. The continuation of the recent decline in interest rates should go a long way toward solving the interest payment problems that had arisen in Brazil and all other capital importing countries. The Government's policies should reverse the present slowdown in the rate of economic growth and establish a sound basis for a return to the country's traditional long-term growth trend.

Mr. Nagashima said that he agreed with the staff appraisal. The performance of the economy in 1980 had been marked by an impressive growth rate of 8 per cent and a very high rate of inflation. The various adjustment measures that had been taken since late 1980 had led to an improvement in both the rate of inflation and the external position, but the rate of inflation was still close to 100 per cent, and the current account deficit was still equivalent to approximately 4 per cent of GDP in 1981, thereby indicating the need for further adjustment measures. He was pleased to learn from Mr. Kafka's opening statement that the authorities were adopting a number of additional measures.

Although it was difficult to grasp the exact state of public finances because of the lack of consolidated accounts for the entire public sector, Mr. Nagashima went on, the fact that the volume of public sector spending would be greater in 1981 than had been anticipated was somewhat discouraging, particularly in view of the progress that had been achieved in 1980. Given the large size of the public sector deficit, attention should be focused on the need to control the operation of public enterprises, whose large capital expenditures, although financed mostly by foreign borrowing, had strengthened inflationary pressures and had harmed the external position. The tight cash position of state enterprises had led to an increase in the floating debt and to greater recourse to domestic bank financing, and it was encouraging that the authorities were taking steps to prevent such financing and to postpone, or to slow the pace of, expenditure on many investment projects by state enterprises. The attempt by the authorities to reduce both the number of state enterprises and the Government's participation in the economy were commendable.

Commenting on the accounts of the Central Government, Mr. Nagashima said that the authorities should resist pressures to bolster spending and should take steps to promote an increase in revenues. In that connection, further improvements in the mechanism for controlling expenditures were needed, and government statistics should be made more extensive and up to date. He hoped that the recent establishment of the Secretariat of Internal Control, and the series of additional measures that had recently been taken to strengthen fiscal control, would reduce the budget deficit.

A number of corrective measures had already been adopted in 1981 to tighten monetary policy, Mr. Nagashima noted. The ceilings on interest rates had been partially freed, although interest rate subsidization still seemed to be extensive, and the authorities should be urged to continue their efforts to reduce credit subsidies. The growth of financial savings had responded quickly to the increase in domestic interest rates. The ratio of gross national savings to GDP had declined in the period 1974-79, but the trend had changed somewhat in 1980, and he hoped that the situation would improve substantially in 1981 and 1982.

The staff had correctly concluded that the present wage formula was inflexible and had not contributed to the effort to reduce inflation, Mr. Nagashima remarked; a system of free collective bargaining at all wage levels might well be preferable. In any event, the recent change in the formula for determining the minimum wage, so that adjustments were based on 100 per cent of the increase in the cost of living rather than 110 per cent as in the past, was welcome.

The substantial improvement in the trade account was also welcome, Mr. Nagashima said, and it was clearly due to the modification of the exchange rate in late 1980 and to other measures to promote exports. However, the improvement in the trade account in 1981 would probably be largely offset by interest payments on the country's external debt. Total debt service payments in 1981 were expected to exceed $15 billion, more than half of which would probably consist of interest payments. Mr. Kafka had mentioned that the Brazilian authorities intended to maintain the volume of foreign borrowing in 1982 in order to add $1 billion to reserves. It might be wise to consider reducing the level of the existing external debt when balance of payments conditions permitted.

The recent introduction of several new exchange and trade restrictions was regrettable, Mr. Nagashima considered. It would be useful to know more about the reasons for the introduction of the special tax on exports of a number of products destined for the United States. He was willing to accept the proposed decision on the understanding that the new restrictions had been introduced on a temporary basis.

Mr. Schneider commented that, since the 1980 Article IV consultation with Brazil, the authorities had taken a number of policy decisions to bring the economy back on track. The adjustment measures had already had positive effects on the balance of payments and the rate of inflation, but deep-rooted structural problems remained. Brazil had suffered severely from the energy crisis and, until recently, had been unable to recover from high inflation rates. The country's economic problems were numerous and interrelated, but the authorities now seemed to be determined to tackle them properly. The short-term effects of their efforts might well show up only in certain parts of the economy; and the longer-term objectives were likely to be achieved only with the implementation of the measures described in the staff report.

Despite the acceleration in the rate of inflation to more than 100 per cent and the further deterioration in the external position in 1980, Brazil had enjoyed a reasonably high rate of growth in that year, Mr. Schneider noted. The substantial improvement in the trade account expected in 1981 would be more or less offset by an increase in debt service payments. However, because of the strengthening of foreign confidence and a corresponding increase in the inflow of medium- and long-term funds, the overall balance of payments deficit was expected to fall to $724 million in 1981 compared with approximately $3.7 billion in 1980.

The authorities' intention of adopting further measures for the period immediately ahead was welcome, Mr. Schneider continued. They still had some way to go to overcome the structural imbalances that had developed in the past as a result of external factors and inadequate implementation of fiscal and monetary policies, and he agreed with the staff that the new measures seemed more comprehensive and far-reaching than those previously adopted. The authorities had introduced a number of measures to strengthen the public finances and they were using a new approach to supply and demand policies.

In the field of public finance, Mr. Schneider continued, the new measures were designed to achieve substantial cuts in, and continuous control of, expenditures; to increase the cash revenues of the Federal Treasury through both institutional and procedural changes; and to give a special emphasis to improving the state enterprises and the social security and wage systems. Enhancing the control over public expenditures and reducing the level of such expenditures were of crucial importance to the public sector itself and to the success of all related economic policies.

The staff had not provided 1981 data on public sector fixed investment, Mr. Schneider noted. The available data indicated that the ratio of fixed investment to GDP had fallen from 25 per cent in 1974 to less than 22 per cent in 1980. Brazil had experienced an upward trend in public expenditure in recent years, and he wondered whether the decline in the ratio of public sector fixed investment to GDP implied that there had been an improvement in resource allocation.

The prospects for changing the present rigid wage formula seemed to be rather dim, at least for the time being, Mr. Schneider commented. It remained to be seen whether there would be, as Mr. Kafka had suggested in his opening statement, a basic change in the attitude of the trade unions. Hence, a high priority should be given to maintaining a tight fiscal policy in order to achieve a better allocation of resources than in the past. The relatively high rate of economic growth in 1980 of about 8 per cent had probably improved certain segments of the economy, but domestic demand had continued to be sufficiently strong to fuel inflation and to worsen the country's external competitive position. The recent efforts to contain private demand, by introducing price liberalization and to promote the external position, through more realistic exchange rate adjustments, a more flexible interest rate policy, and incentives for foreign private capital inflows, were welcome. Nevertheless, the persistent difficulties in further liberalizing the trade and exchange rate systems was a matter of major concern. The newly introduced restrictive practices were disappointing, and he hoped that they would be eliminated as soon as possible. The proposed decision was acceptable.

Mr. Laske commented that in late 1979 and the first half of 1980 the Brazilian authorities had adopted a number of stabilization measures that they had hoped would contain inflationary pressures and improve the balance of payments. Their hopes had been disappointed, as in 1980 the rate of inflation had jumped to more than 100 per cent, twice the rate that had been projected, the balance of payments position had weakened considerably--although some improvement was expected in 1981--and Brazil's foreign debt had further increased. The staff did not seem to be worried about the expected increase in Brazil's long-term external debt to as much as $61 billion in 1981. In 1980 net debt service payments had amounted to $13 billion, of which roughly one half had consisted of interest payments alone. The debt service burden had absorbed more than half of Brazil's export receipts in 1980, and debt service obligations were expected to continue rising in 1981. According to press reports, the Minister of Planning expected Brazil's external debt to rise by about $7.5 billion during the coming 12-24 months. He wondered whether that pace of international borrowing could be maintained for long, and whether the investment projects financed by the loans would produce sufficient foreign exchange earnings and savings to cover the inevitable debt service payments.

Concern about Brazil's large external debt had been expressed on a number of occasions in the past, Mr. Laske recalled, and occasionally the international banking community had shown some hesitancy to increase its exposure to that country, although in the end the necessary funds had always been forthcoming. Conversations he had recently held with bankers suggested that they might well be reluctant in the coming period to extend further loans, partly because of the existing large volume of debt, and partly because of certain aspects of Brazil's economic policies.

The effort to reduce the rate of inflation had relied excessively on monetary policy, Mr. Laske commented, and fiscal policy had not succeeded in checking the growth of expenditures. A significant portion of public expenditure had had to be prefinanced through advances from the monetary authorities, who had tried to mop up the resultant excess liquidity in open market operations. Although the operations had succeeded in neutralizing the Central Bank's advances, the counterinflation objectives of monetary policy had clearly been undermined, at least temporarily, by both those advances and the limited extent to which interest rates were determined by market forces. Less than one third of the financial system's loans in the recent past had been made at market rates. The recent increase in the interest rates on consumer loans to a relatively high level might not have much of a restraining effect on total credit demand.

The authorities had adopted certain measures in 1981 to tighten monetary policy, Mr. Laske went on, but considerable further strengthening was needed to ensure the success of the counterinflation effort. That the monetary authorities had had to finance twice as large a volume of government expenditures as had been originally budgeted for 1981 was certainly worrying. In addition, the Central Bank had continued to make loans at highly subsidized rates and without any global limits on the amounts involved. The intention of the authorities to reduce interest rate subsidies in 1982 and to cease extending cheap loans for selected purposes in unlimited amounts was welcome; he hoped that they would act promptly. They expected the interest rate subsidies to fall in line with the decline in the rate of inflation, but he agreed with the staff that, in the effort to raise real interest rates, they should attach more importance to increasing nominal interest rates than to relying on a decline in the rate of inflation, something that could not be expected with any great certainty.

During the discussion of the staff report for the 1980 Article IV consultation with Brazil, several speakers had raised questions about the wage formula, Mr. Laske recalled. Experience had shown that the formula had not worked as had been expected, partly because of the effects of the high rate of inflation, and partly because of growing doubts about the benefits of the formula. However, changing the formula to any great extent would probably not be possible in the coming period. The recent modification of the formula, so that wage adjustments would be based on 100 per cent of the cost of living index, rather than 110 per cent of the index, was a step in the right direction, but not a strong one.

As a result of the deterioration in the external current account in 1980, Mr. Laske noted, the authorities had adopted a number of restrictive measures that required approval by the Fund under Article VIII. He was willing to approve them but only in the expectation that they would be eliminated quickly, in line with the projected improvement in the external current account position.

Mr. Lovato considered that the performance of the Brazilian economy in the past year or so had been mixed; there had been some positive developments, but some aspects of the economy were a cause for great concern. The economy had maintained its good record of growth of real output in 1980, but the rate of inflation, which had been expected to decline, had actually reached a very high level. Corrective actions had certainly been needed, and the measures that the authorities had already taken were welcome, even though they had caused a decline in the rate of growth of the industrial sector and an increase in unemployment. During the previous few months, the growth in exports and the restraint in imports had resulted in a positive trade balance that should help to strengthen the external position, which had been growing alarmingly weak. There were obviously some unsolved structural problems--especially the large size of the external debt--counterbalancing the improvements in certain aspects of the balance of payments, but that situation was common to many countries, especially developing ones, and its existence underscored the need for continual care in the design of economic policy in order to avoid unstable conditions.

With the benefit of hindsight, Mr. Lovato commented, it was now clear that the Government's policies on the exchange rate and to counter inflation had not been fully appropriate. The increasingly negative interest rates and the real appreciation of the exchange rate after the adoption of an unrealistically low target for the rate of inflation had probably increased the need for demand restraint in 1981 to a greater extent than would have been the case otherwise. Brazil was an interesting example of the dangers that faced economic policymakers when their objectives did not match the expectations of the public. A real depreciation of the cruzeiro should be sought, at least for a while longer, to make up for the appreciation in 1980. Once a reasonable degree of competitiveness had been re-established, however, a stable real exchange rate would be needed to support the counterinflation effort.

The steps that the authorities had taken to permit market forces to play a greater role than in the past in the determination of interest rates were welcome, Mr. Lovato said. The effectiveness of monetary policy depended on the transmission of signals to the economy through changes in the cost of financial capital, a function that had been seriously impaired by the existence of a large volume of loans made at negative real interest rates; the burden of those loans had fallen on the public finances.

He agreed with the staff, Mr. Lovato went on, that the performance of the public sector had to be strengthened. The steps in that direction which had already been taken were quite encouraging, and he hoped that there would be no unexpected developments preventing the effects of those measures being fully felt.

The once-and-for-all effects of the recent liberalization of controlled prices, and the relative stability of international energy prices, should contribute to a favorable environment for achieving a decline in the rate of inflation, Mr. Lovato remarked. Given the present rate of inflation in excess of 100 per cent, the absence of a mechanism for adjusting wages would probably create difficult labor relations, which might disrupt economic activity. The present wage formula was clearly meant to redistribute income and, if adjusted, it might still be appropriate for a country like Brazil, which had experienced high rates of economic growth but still had large differences in income among the various groups of wage earners. A system of free collective bargaining seemed preferable to the existing system in Brazil, but it might not be feasible at the present stage. Although problems clearly remained, the wage situation should be approached with caution. Finally, Brazil's growth record was impressive, and the potential for further development was still considerable; the present economic stance seemed to be an adequate response to the negative developments that had occurred in 1980 and should permit the trend of rapid growth to continue.

Mr. Williams stated that he broadly agreed with the staff appraisal and accepted the proposed decision, although he urged the authorities to persist with their firm and steady adjustment effort to permit the early elimination of the payments restrictions.

The staff had thoroughly described the promising effects on inflation and external trade of the measures that the authorities had adopted in late 1980, Mr. Williams continued. The measures had also clearly had a marked impact on growth and employment. However, the staff could have usefully paid greater attention than it had to the likely course of future developments in the economy; projections of the internal and external imbalances for 1982 would have been particularly useful, as they would have given Executive Directors a more comprehensive basis on which to judge the effectiveness of the end-1980 measures and to decide whether or not their coverage and pace were sufficient to provide a basis for sustainable growth.

The recent tightening up of the administration of fiscal policy was welcome, Mr. Williams commented, but the revenue performance in 1981 had been sluggish, and the additional income tax measures that were now under consideration seemed sensible and appropriate, especially in view of the growth in real wages. He wondered whether there was any scope for improving the revenue yield of the fuel tax; the receipts had fallen significantly as a proportion of GDP since 1978, and greater buoyancy would enhance overall revenues and support the authorities' otherwise very commendable energy policy.

He agreed with the staff and the authorities, Mr. Williams said, that the rate of growth of central government expenditures in the previous year was a cause for concern. It had been caused primarily by a subtantial growth in the wage bill and by an increase in the transfers to the state economic enterprises. There was a need to improve the effectiveness of public expenditure control and planning to ease the constraint that the fiscal deficit had been placing on the conduct of monetary policy. The recent tightening of the control over the operations of the state enterprises was certainly welcome, and the reform in the financing of the social security system which Mr. Kafka had mentioned was interesting. Two of the key proposals--to reduce the adjustment factor applicable to minimum pensions, and to reduce the pensions of recipients who returned to full-time employment--had been rejected by the Congress, and it would be useful to know whether alternative proposals were being considered.

Commenting on monetary policy, Mr. Williams said that at end-1980 credit subsidies had been applied to approximately 70 per cent of loans and credits of the financial system representing about 4 per cent of GDP. Such subsidies seemed likely to distort the allocation of resources or, at least, to produce major unintended effects. Hence, he hoped that the authorities would follow through on their intention to reduce credit subsidies and to close the so-called open accounts. The impediments that such facilities could create for effective credit control were reflected in the rapid increase in the rate of expansion of the net domestic assets of the banking system from 70 per cent to 80 per cent a year between December 1980 and July 1981, compared with the target of 50 per cent for the year as a whole. Nevertheless, he welcomed the steps that had already been taken to tighten monetary policy, including the freeing of certain interest rates and the introduction of stricter quantitative controls over bank credit, although the latter was certainly a second-best expedient. It would be important in the coming period to permit domestic interest rates to rise further, if necessary, to maintain the differential with foreign rates needed to attract sufficient foreign capital.

In the field of supply-side measures, Mr. Williams remarked, he wondered whether the staff had made any projections of the likely medium-term contribution that agriculture would make to GDP, for instance, in 1985 and 1990, particularly in view of the special emphasis that was now being placed on the development of that sector. It would also be useful to know whether there were any updated forecasts of oil production. The staff report for the 1980 Article IV consultation with Brazil had contained an estimate of oil production of some 500,000 barrels a day by 1985. Did that forecast still hold good in the wake of the recent step-up in exploration activity?

On previous occasions, Mr. Williams recalled, Executive Directors had expressed some concern about Brazil's method of determining wages. The present wage formula continued to be an obstacle to any rapid reduction in the rates of inflation and unemployment, although in his opening statement, Mr. Kafka had suggested that the attitudes in Brazil toward wage policy seemed to be changing. An early amendment to the official wage formula might well be difficult to achieve, but he hoped that the ongoing discussions in Brazil on how to make the wage law more flexible than hitherto would continue in the coming period.

The authorities' success in reducing the growth of domestic demand had contributed to the marked strengthening of the external position, Mr. Williams observed. Recently adopted policy measures, together with a willingness to accept an increase in the cost of external borrowing, appeared to have restored the confidence of foreign investors, at least for the time being, but the current account was still vulnerable to fluctuations in oil prices and interest rates, and Brazil's external borrowing needs would presumably remain sizable for some time. In the circumstances, the authorities should continue their restrictive overall policy stance.

The inflow of foreign direct investment had fallen in 1980 and again in the first half of 1981, Mr. Williams noted. It would be useful to know whether the authorities intended to arrest the decline and, if so, how. It would also be useful to have the staff's views on whether the restrictions on outward remittances constituted a major disincentive to foreign investment.

He agreed with the staff, Mr. Williams said, that the renewed restrictions on exchange and trade were not an efficient method of achieving cost competitiveness in the longer term. It was important both for Brazil and for the credibility of the Fund's surveillance policy to ensure that the restrictions were temporary. He wished to join with the staff in endorsing the authorities' new policy on exchange rate management; it would be useful to know whether any real depreciation had yet taken place as a result of the policy.

Mr. Erb remarked that the data provided by the staff suggested that the expected improvement in the trade balance in 1981 was due largely to a decline in imports; exports seemed to have remained virtually flat since the fourth quarter of 1980, despite the increase in fiscal and interest rate subsidies. More active adjustment of the exchange rate seemed called for to stimulate export growth and to facilitate the removal of the existing multiple currency practices, particularly the tax on financial transactions. Did the staff feel that, given the expectations for the growth in domestic demand in 1982, the new policy of permitting a depreciation of the cruzeiro by the full percentage rate of domestic inflation would be sufficient to maintain a continuous improvement in the external trade balance? External competitiveness would be determined in part by the trend in real wages, and in part by the movement of the exchange rate. The information provided by Mr. Kafka on recent changes in the wage law was encouraging; he hoped that it signaled a renewed determination to maintain an incomes policy that would be sustainable in the long run.

The authorities continued to provide substantial subsidies, particularly in the form of tax credits and subsidies on interest rates, but including subsidies on selected food consumption items, Mr. Erb noted. A further reduction in the subsidies would make a positive contribution to the effort to improve the fiscal performance by increasing revenues and reducing transfer expenditures. A reduction in the interest subsidies would also assist the authorities in their efforts to control credit growth, especially as there were no global limits on certain components of the subsidized credit. The expected deceleration in the rate of inflation should reduce the quantitative impact of the interest rate subsidies, but considerably more should be done to bring interest rates closer to market levels. Mr. Kafka's statement that further interest rate increases were under study was encouraging, and the authorities should be urged not to delay action. Reducing and eliminating interest rate and other subsidies would contribute both to demand management efforts and to a more efficient allocation of resources in the medium run.

The authorities had made noteworthy progress in the past year in acheiving balance of payments adjustment and in reducing some of the distortions in the economy, Mr. Erb considered. In the light of those improvements, they should be urged to renew the earlier trend toward greater trade liberalization and to eliminate the multiple currency practices at the earliest possible date. Given Brazil's large external debt and the heavy debt servicing burden, the margin for policy error in the coming one or two years was relatively small, but he was confident that the authorities would continue their adjustment efforts with the same degree of persistence that they had shown in the previous year.

Mr. Nimatallah stated that he generally agreed with the staff's assessment of the Brazilian economy. The authorities had reacted with courage and determination to the deterioration in the financial situation in 1980. Their policies had already shown some positive results: the rate of inflation had fallen in 1981; the employment situation had improved; and there had been a substantial improvement in the balance of payments. He was pleased that the successful policies that had been introduced in 1981 were to be maintained in 1982.

Commenting on the supply-side policies, Mr. Nimatallah said that the adjustments in support prices for agricultural products had helped to stimulate production. In addition, oil production and pricing policies had contributed to an appreciable rise in the ratio of oil production to net consumption of oil, and the recent changes in the wage policy had had a positive effect on the stabilization effort and the employment situation. However, he agreed with the staff that further steps would have to be taken in the area of wage policy, and the ongoing discussions on ways of making the wage law more flexible than hitherto were encouraging.

Several measures had been introduced in 1981 to improve the financial situation, Mr. Nimatallah commented, including steps to strengthen monetary management, bolster government revenues, tighten public sector spending, and improve the finances of the social security system. The authorities were to be commended on their demand management policies, and they should be encouraged to implement such policies in coming months even more vigorously than they had in the recent past.

Several factors had caused the substantial improvement in the balance of payments position in 1981, Mr. Nimatallah noted, including the flexible exchange rate policy, the stabilization in import payments for oil, and the prudent domestic economic policies. Further improvement in the balance of payments position was expected in 1982, and the present multiple currency practices and payments restrictions were seen to be temporary in nature; they could be eliminated as the balance of payments position further strengthened in coming months.

The Brazilian Government had set a good example for many developing countries, Mr. Nimatallah considered. The authorities had adopted appropriate measures to achieve rapid economic growth and to distribute income equitably, and they were taking steps to permit the private sector to play a more active role than hitherto in the economic development process. The Government had said that it was prepared to sell public enterprises to the private sector at an appropriate time, a policy that should help to increase efficiency and competition. At the present stage of economic development in Brazil, the authorities would find it particularly helpful to liberalize the economy and to permit the private sector even greater participation than hitherto in the management and control of the economy.

Mr. Casey considered that, given the high rate of inflation, the partial price liberalization of the economy in the previous year had been highly commendable and courageous. That policy, together with other adjustment measures, had already begun to pay dividends in the form of a recovery of efficiency and a decline in unemployment. Moreover, the recent tying of interest rates and the exchange rate to the actual rate of inflation, rather than the targeted rate, had helped the balance of payments, the reserve position, the credit rating of Brazil, and the price performance. However, he agreed with previous speakers that a much greater reduction in credit subsidies was needed. Mr. Kafka's statement that the rate of credit expansion in 1982 was certain to fall short of the rate of inflation--which itself was expected to decline to 70-80 per cent--was encouraging.

On the fiscal side, Mr. Casey continued, a further tightening of policy was warranted. The increased recourse by the Government to domestic borrowing had strengthened the role of monetary policy, but a fundamental fiscal correction was still required. The authorities had adopted several measures to increase tax revenues, and the promised reduction in export subsidies in 1982 would constitute a major step forward. They had already begun to curb public spending, especially by the state economic enterprises, but much remained to be done in that area, particularly in the light of recent slippages. The newly created Secretariat of Internal Control should make a useful contribution to the process of fiscal retrenchment. The additional fiscal measures that Mr. Kafka had mentioned, including the changes in the social security and tax deduction systems, the hiring freeze, and the postponement of relatively less essential projects, would help to improve the public finances and, thereby, the price performance. As Mr. Williams had suggested, an increase in the energy tax might well be worth examining.

The backward-looking form of wage indexation was still a major problem, Mr. Casey considered. It had undermined the efforts both to increase employment and to reduce inflationary expectations. Mr. Kafka had usefully noted that trade unions had become more aware of the adverse effects on employment of excessive wages, and he wondered what had led the unions to change their minds. The reduction in the wage indexation formula was welcome, but he agreed with the staff that a shift to free collective bargaining might have to be considered if the existing wage system remained essentially inflexible. He wondered whether such a shift was likely to occur, and what the consequences were likely to be for industrial relations.

The Government's energy conservation and exploration policies were exemplary, Mr. Casey considered. Indeed, almost all of the new policies--with the possible exception of the incomes policy--were in the right direction. The pace of adjustment could perhaps be somewhat faster than it had been, but the Brazilian authorities were in the best position to make that judgment.

Brazil's economy was quite complex, Mr. Casey commented, and it was not clear to him how the authorities had achieved a rapid rate of economic growth over a number of years despite the high rates of domestic inflation and the entrenched inflationary expectations. Had rapid growth been made possible by the natural resource base and by the attraction of foreign industry and capital, or by the experience that Brazilians had gained in living with inflation? What had been the hidden costs of inflation? Had they, for example, included efforts spent in designing indexation systems, the accumulation of external debt, and a relatively low level of exports as a share of GNP?

He hoped that the encouraging prospects that Mr. Kafka had described in his opening statement would fully materialize, Mr. Casey said. The expected strengthening of the balance of payments was particularly welcome, especially in the light of Brazil's high debt service ratio; it would permit the authorities to remove the recently introduced trade and exchange restrictions and it would release resources in the private capital markets, therebv benefiting the global recycling process.

Mr. Kabbaj commented that he had visited Brazil in early 1980 and, having met the government officials responsible for economic policy, he had not been surprised by the generally encouraging results described by the staff and Mr. Kafka. Given the present global recession and the numerous economic difficulties facing most of the oil importing countries, the achievements of the Brazilian economy were commendable. There had been some setbacks, and intense inflationary pressures could be a major factor in the coming years, although they had declined somewhat in the first half of 1981. The liberalization of practically all producer and consumer agricultural and industrial prices in 1979, the wage policy aimed at keeping pace with the cost of living index, and the expansionary financial policies had kept the authorities from decisively curbing the rate of inflation. The staff had appropriately stressed the need for further restraint and for a review of the wage policy, as it had adversely affected employment and productivity as well as the price performance. Fortunately, the authorities, and even the unions, had become aware of the problem, and some appropriate measures had already been adopted.

However, Mr. Kabbaj went on, the performance of domestic output and of the balance of payments reflected the obvious strength of the Brazilian economy. The real rate of growth of GDP had risen to 8 per cent in 1980 and was likely to be significant in 1981--despite the slowdown in industrial output in the first seven months of the year--mainly because of the continued strong agricultural output and the expansion of domestic oil production, the net consumption of which had reached 10 per cent in 1980 and was expected to rise to 30 per cent in 1982. Moreover, the apparent recovery in industrial output in the second half of 1981 seemed to be the first sign that the level of unemployment was falling.

The prospects for the balance of payments were also encouraging, Mr. Kabbaj continued. In 1981 the trade balance would probably be in surplus for the first time since 1977, as the value of exports was expected to rise by 18 per cent and imports were projected to decline somewhat. The surplus would probably be largely offset by the increase in interest payments on Brazil's foreign debt, but the current account deficit should be reduced as a percentage of GDP and, in view of the renewed confidence of the capital markets in the Brazilian economy, no difficulty in financing the deficit was expected. It would be useful to receive further information on the rise in the external debt--both its value and its relation to GDP--and on the impact it would probably have on Brazil's economy in general, and on the balance of payments in particular.

The favorable economic trends in 1981 had resulted from the cautious demand policies implemented in 1980, Mr. Kabbaj commented. The courageous set of measures had increased the control over credit operations through the introduction of quarterly ceilings and had slowed the expansion of both net domestic assets and bank liabilities to a rate considerably less than the rate of inflation. The exchange tax on a wide range of imports had been raised from 15 per cent to 25 per cent, and a temporary export subsidy of 15 per cent had been reintroduced. Other measures had been taken to relieve the congestion in the public sector--particularly through sales to the private sector of some state-owned enterprises--and to improve the financial position of the social security system.

In late 1980, Mr. Kabbaj went on, the authorities had also modified the exchange rate policy to promote external adjustment. The new policy of depreciating the cruzeiro in line with the movement of domestic inflation, together with the major devaluation of the currency in 1979, had apparently had a welcome positive impact on exports, but he wondered whether it would have had the same quick effect in developing countries that did not have the kind of strong economic base that Brazil had enjoyed. Finally, given the positive trends resulting from the Government's economic policy stance and the temporary nature of the measures that were subject to approval by the Fund under Article VIII, he could accept the proposed decision.

Mr. Prowse commented that his first reaction on reading the staff reports was to wonder whether any problems faced the Brazilian economy; after all, real economic growth had reached 8 per cent in 1980, and real per capita GDP had risen by 5.6 per cent. However, in the opening paragraph of its appraisal the staff had cautioned that, although the growth rates had been good, the economic situation continued to be difficult in "other respects." The Brazilian economy's unusual growth potential and actual performance raised fundamental questions concerning the Fund's approach to foreign borrowing by members, the relationships between inflation and growth as well as actual growth and potential growth, and the effects of exchange rate adjustments. Brazil was an exceptional economy; so much so that it almost required a new set of economic theories.

Despite its relatively good growth performance, Mr. Prowse went on, certain areas of Brazil's economic management were unsatisfactory, such as the inadequately controlled government expenditure, the negative real interest rates, the subsidized prices and interest rates, and the weak performance by state economic enterprises. Inflation had become corrosive and destructive, and the external position was no longer viable.

Nethertheless, not only had the economy grown at an impressive rate in 1980, but the balance of payments position appeared to have strengthened in recent months.

The answers to the kinds of questions that naturally arose about Brazil's economic performance could be answered only in the context of the longer run, Mr. Prowse continued. Hence, it was important to compare both actual growth in Brazil with the country's potential growth, and Brazil's performance with that of other economies. In the 1960s and 1970s, a period of external stability and relatively moderate inflation in Brazil, the country's growth rate had exceeded 11 per cent compared with an average of 6 per cent for all non-oil developing countries. In 1978 and 1979, real growth in Brazil had been 3.8 per cent and 3.4 per cent, respectively, considerably lower than the 5.25 per cent and 6.5 per cent recorded by all non-oil developing countries.

The good growth performance in 1980 had been due in part to the strong demand for industrial goods and in part to a good harvest, Mr. Prowse commented. The demand for industrial goods had been caused initially by the large exchange rate adjustment in 1979. Later in that year, however, domestic demand had strengthened, and there had been an accumulation of stocks and a shift from financial assets to consumer goods, trends that could not constitute a basis for sustained growth. At present, the exchange rate devaluation seemed to be contributing to the inflationary surge as well as to the growth in exports. Hence, there were some difficulties in the area of economic management which would have to be dealt with if Brazil was to reach its potential growth capacity.

There were also some structural problems, including the maze of controls, regulations, and subsidies, Mr. Prowse went on. In addition, attention would certainly have to be focused on Brazil's external deficit. The external debt situation was not as serious as one might suspect at first glance; it was certainly appropriate for Brazil to run a current account deficit, import real capital, and borrow in the international capital markets. The main question in the case of Brazil, as it had been in the recent case of India, was the level of foreign borrowing that was appropriate and viable.

In the period January-June 1981, Mr. Prowse noted, the current account deficit had amounted to $5.8 billion, and interest payments to $3.8 billion. Total debt service costs in 1980 had been the equivalent of 60.9 per cent of imports, thereby suggesting that the country might face a debt management problem. It was fair to ask whether Brazil should have depended in the past, or should depend in the future, more on direct investment than on loans. The country's foreign borrowing policy was certainly one area to which further attention should be paid by the authorities. In that connection, it would be useful to know more about the nature of the flow of capital into Brazil. The relevant main item in the balance of payments was "commercial credits," and he wondered whether it consisted of private enterprise borrowing, state enterprise borrowing, trade credit, or government-guaranteed borrowing.

Brazil's reliance on imported petroleum was so extensive that a review of policy in certain areas, particularly transport, was called for, Mr. Prowse considered. He wondered whether it was appropriate for the motor vehicle industry to continue to be seen as the main factor in the industrialization of Brazil.

Mr. Alhaimus considered that the authorities were to be commended for their efforts to improve economic conditions in general in Brazil, and to fight the inflationary pressures in particular. In late 1979 and early 1980 they had adopted a set of adjustment measures that had resulted in an 8 per cent increase in real GDP. Industrial production had expanded in response to the rise in domestic and foreign demand, and the widespread liberalization of producer prices together with favorable weather conditions had led to a high rate of growth of agricultural output.

The authorities seemed to be fully aware of the need for further actions in 1981 to stabilize the economy, Mr. Alhaimus continued, even though they had already succeeded in diversifying the economy and in penetrating new export markets. The export incentives provided by the Government, and the ability of the economy to supply relatively high-technology products had helped to improve Brazil's competitive position in the export markets of industrial and developing countries. In addition, the availability of new financing facilities and the implementation of projects had made a considerable contribution to the favorable agricultural performance.

The energy policies that the authorities had introduced had been sound, Mr. Alhaimus considered. The rise in the domestic prices of oil products and the increase in investment in exploration activities had resulted in a greater reliance than in the past on domestic oil production and in a corresponding improvement in the external position. The authorities had also taken useful steps to encourage energy conservation and the use of alternative sources of energy.

Commenting on Brazil's financial policies, Mr. Alhaimus noted that several measures had been introduced to alleviate the pressure on financial resources. The elimination of certain ceilings on domestic interest rates and the increase in the subsidized rates on loans had played a considerable role in stimulating domestic savings and in reducing the demand for bank loans. On the fiscal side, the authorities had adopted measures to reduce further the existing disparity in the growth rates of revenues and expenditures. The improvements in the operation of the state enterprises, and the authorities' intention to reduce the number of those enterprises, were expected to cause a decline in government outlyas; and the proposed adjustments in the finances of the social security system seemed to be appropriate. The corrective measures appeared to have begun to yield some positive results; the rate of inflation had begun to decelerate in April 1981 and was expected to continue to decline in 1982.

Brazil's external position had also improved substantially in 1981, Mr. Alhaimus commented. The expected trade surplus and the decline in the current account deficit showed the effectiveness of the measures that had been introduced in late 1980. The external position was expected to strengthen considerably by the end of 1981.

Miss Le Lorier considered that the Brazilian economy had shown remarkable flexibility in quickly responding to the important adjustment measures that had been adopted in 1980. She agreed that it would be useful to have more information on the difference between the real and potential growth rates. She had been struck by the difference in the performance of the agricultural and industrial sectors, and she wondered whether the manufacturing sector was not bearing an excessively heavy burden of the tightening of monetary policy. Had the increase in the volume of credit for agriculture been achieved at the expense of the manufacturing sector? Was the available export finance sufficient to cover the expansion of the manufacturing sector?

The tightening of demand management policies in Brazil was welcome, Miss Le Lorier continued. The restrictive impact of the credit ceilings might well be much stronger than had been originally expected; the ceilings applied both to amounts borrowed and to interest payments to the banking system. It would be useful to receive further information on the effect of the credit ceilings on the growth of credit. The authorities' intention of further reducing credit subsidies in 1982 and of closing the so-called open accounts was certainly welcome, as the actions would increase the flexibility and efficiency of monetary policy.

Commenting on public finance, Miss Le Lorier said that including the credit subsidies in total central government expenditures might help the authorities to gain a clearer understanding of the room that was available for further curbing public expenditure. As for wage policies, the sluggish economic growth and the rise in unemployment had probably reduced the rigidities resulting from the use of the present wage formula, but the authorities should make the wage law itself somewhat more flexible rather than follow the practice of dismissing workers and hiring new ones at lower wages as a way of dodging the provisions of the law.

The rapid restoration of balance in the trade account was impressive, Miss Le Lorier remarked. Would the trade surplus in 1981 permit the authorities to phase out the export subsidies and import restrictions more rapidly than they had originally anticipated? On the whole, the progress that the authorities had made in their adjustment effort thus far in 1981 was impressive. She hoped that the deceleration in inflation would continue, perhaps at an even faster pace, in the coming months, thereby permitting the authorities to remove the existing restrictive measures.

Mr. Polak considered that the various demand management measures that the authorities had adopted during the previous year had improved the balance of payments position at a tolerable cost. Previous speakers had usefully elaborated on that point, and he would concentrate his remarks on the exchange rate and price policies.

Despite its considerable experience with high rates of inflation, Mr. Polak went on, Brazil had not learned to live with them effectively; indeed, inflation seemed to be even more harmful now than it had been in the past. The great majority of interest rates had been close to the rate of inflation in mid-1979, but were now well below inflation; and important distortions had been introduced as a result of the widespread subsidization of credit. The credit subsidies had clearly added to the inflationary pressures in Brazil. In general, the Government's demand management policies in the previous year had not been particularly effective in reducing inflation, which had been in excess of 100 per cent since mid-1980. Certain corrective price adjustments had pushed the rate of inflation to a peak of 121 per cent in March 1981, and the staff seemed to feel, although not very strongly, that the tighter demand policy since then had resulted in the moderate decline in the rate of inflation, to 110 per cent by August 1981. In his opening statement Mr. Kafka had predicted that the rate of inflation would fall to 70-80 per cent in 1982, and it would be useful to know how that result was to be produced. Could it be argued that in Brazil, unlike many industrial countries, improved control over monetary policy was effective mainly on the prices of goods, and not their quantities? In any event, the transition from a yearly adjustment of wages to a half-yearly adjustment would serve only to accelerate inflation; that move was much more important than the recent reduction in the wage index adjustment from 110 per cent to 100 per cent. In any event, the staff could have usefully provided monthly or quarterly price indices, rather than merely give inflation figures for 12-month periods.

The Government's exchange rate policy, Mr. Polak said, was aimed at achieving a small depreciation in real terms by correcting the exchange rate on the basis of movements in prices in Brazil; no account was to be taken of price movements abroad. The staff had mentioned that the policy had worked, as there had been a 3.5 per cent real depreciation against the U.S. dollar in the previous 8 months; however, Chart 4 in the staff report showed that, in the same period, the cruzeiro had appreciated by a larger amount against Brazil's trading partners as a group. In that connection, it would be useful to have the staff comment on the effect of a depreciation on the real rate of exchange for the cruzeiro. Chart 4 also showed that, in terms of the real effective exchange rate, the results of the maxidevaluation of 1975 had been lost. The exchange rate obviously had to be adjusted in response to inflation, but given the inflation adjustment mechanism in Brazil, a relatively rapid depreciation probably would affect the real effective exchange rate only in the very short run, and another maxidevaluation might well be needed if the real effective exchange rate was to be permanently affected.

He was willing to approve the payments restrictions on a temporary basis, Mr. Polak stated. He shared the reservations about them that had been expressed by the staff and Mr. Laske.

He had been struck by Mr. Kafka's remark in his opening statement that the Government expected to maintain--rather than reduce--the volume of foreign borrowing in 1982, Mr. Polak recalled. A number of Executive Directors had expressed concern about the size and rate of growth of Brazil's debt. Mr. Kafka had also mentioned that the authorities wished to add approximately $1 billion to reserves in 1982. That figure was the equivalent of 100 per cent of Brazil's quota and should perhaps be kept in mind by those who had expressed the view that continuing SDR allocations in coming years at a rate of SDR 4 billion a year--the equivalent of 7 per cent of the Fund's quotas--would be excessive.

Mr. Buira commented that Brazil had been one of the few countries to achieve high rates of economic growth despite the depressed state of the world economy. Brazil's real GDP had increased by 8 per cent in 1980, up from 6.5 per cent in 1979. The process of economic growth had been hampered, however, by the rather unsatisfactory performance of prices and the external sector.

The performance of the external sector had clearly limited the growth of the economy and had demonstrated the vulnerability of Brazil to developments in the world economy, Mr. Buira continued. The balance of trade had been severely affected by the deterioration in the terms of trade resulting from the increase in oil prices and the decline in the international commodity prices of particular importance to Brazil's export trade; the difficulties had been compounded by the slowing of the growth of international trade. At the same time, the sharp increase in world interest rates had intensified the pressures on other items of the current account. The performance of the external sector had caused the authorities to change their basic economic policy strategy.

Until 1979, Mr. Buira noted, the authorities had sought to prevent the external sector constraining the growth of the economy by maintaining both an exchange rate that reflected the differential between domestic and world inflation, and an overall medium-term strategy designed to strengthen and broaden the country's export potential. That adjustment strategy had caused the external disequilibrium to become evident in the large size of the external debt, and it had relied on the process of economic growth and on the exchange rate policy to produce the flows of exports needed to service the external debt smoothly. The unfavorable developments in the international economic environment, especially the interest rate shock, had undermined the viability of the Government's policy of achieving economic growth on the basis of a steadily rising foreign debt.

It was difficult to overemphasize the adverse consequences on the Brazilian economy of the increase in world real interest rates, Mr. Buira commented. Foreign interest rates had risen well above the expected rate of world inflation; in real terms, the LIBOR (London interbank offered rate) has risen from 1.67 per cent at the end of 1978 to 4.7 per cent in 1979 and 4.9 per cent in 1980-81. Accordingly, the interest rate on Brazil's debt had risen from a level that had been lower than the rate of world inflation to a positive real value of approximately 5 per cent in 1980-81; in money terms, the interest rate change had added $5.3 billion to the volume of Brazil's debt in the period 1978-80. In that period the two main policies of external adjustment--export promotion and automatic exchange rate adjustments--had been unable to compensate for the adverse effects of the financial and external price shocks. As a result, the level of reserves had fallen from $11.9 billion at the end of 1978 to $6.9 billion at the end of 1980. Moreover, there had been a decline in the volume of foreign bank lending to Brazil, thereby leading the Government to resort to $3 billion in short-term financing, in addition to drawing down reserves, to finance the current account deficit.

Drawing down reserves was of course merely a temporary adjustment mechanism, Mr. Buira said, and the authorities had also responded to economic developments by reorienting the strategy of external adjustment, and particularly to increase the emphasis on short-term demand management and to shift a greater share of the burden of adjustment to the domestic economy. That approach seemed to be appropriate, particularly as the rate of expansion of domestic credit, fueled by the public deficit, had reached high levels in 1979 and 1980. The demand management policies introduced in 1980 had not been consistent with the inflation target and the desired pace of the devaluation of the cruzeiro. Indeed, the cruzeiro had appreciated in real terms by 17 per cent against the U.S. dollar and by 21 per cent against the currencies of Brazil's main trading partners; however, it was important to recall that, in 1980, the general price liberalization had considerably affected the prices of both agricultural and industrial products.

The authorities' new overall strategy, Mr. Buira went on, was designed to achieve the needed adjustment in the domestic economy in the short run and to maintain the process of economic growth. A prudent mix of fiscal and monetary policies had been introduced to eliminate excessive aggregate demand. A particularly strong effort had been made to limit the public sector deficit by reducing central government expenditure, containing the deficit of the social security system, and strengthening the control over the operations of the state enterprises. On the monetary side, credit ceilings had been established and progress had been made toward liberalizing interest rates.

The interest rate policy represented the main link beween the short-term and medium-term strategies, Mr. Buira continued. The aim was to attain positive interest rates in real terms during the coming several years, thereby encouraging domestic savings and private borrowing of foreign resources. The higher real interest rates should also help to reduce aggregate demand in the short run and to lessen the dependence on foreign savings in the medium and long run. The authorities were studying other measures to promote the medium-term adjustment of the economy, including ways of encouraging agricultural development and smoothing the trend in real wages.

The new set of policies had already substantially improved the economy, Mr. Buira commented. The trade account had recorded a surplus that was expected to increase in the coming period, largely because of the adjustment policies designed to limit import demand and to increase the competitiveness of exports. Despite the decline in the level of world economic activity, the rate of growth of exports had been remarkable. There had also been considerable progress in the effort to improve the control of inflation, although at a cost, in terms of the rate of growth of GDP and the level of unemployment. The wage policy, which had been designed to link real wage growth with gains in productivity, had played a major role in the counterinflation effort.

The external capital account had significantly strengthened in recent months, probably as a result of the acceptance by the authorities of the increase in the cost of foreign debt, Mr. Buira remarked. The stability of both the ratio of net debt to exports and the ratio of debt service to exports showed that the level of foreign debt was being brought into line with the debt servicing capacity of the Brazilian economy. The size of the debt was large, but the maturity profile was favorable; the level of the foreign debt had reached $53.8 billion in December 1980, and amortizations in 1981 would be approximately $7.6 billion, or 14.3 per cent of the total debt. That ratio was expected to decline further in the coming two years, to 13.1 per cent in 1982 and 11.6 per cent in 1983. Maintaining the relatively favorable amortization schedule would ensure that foreign debt would continue to be manageable in the coming years. Finally, the proposed decision was acceptable.

Mr. Wang said that he had no difficulty in accepting the draft decision. The high interest rates in the international capital markets had had a significant effect on Brazil's external position; most of the improvement in 1981 in the trade balance had been offset by the increase in the interest payments on the foreign debt. The effect of the Government's external adjustment efforts would have been much more positive if the burden of the debt service had been less onerous than had actually been the case. The experience of Brazil clearly demonstrated the crucial important role played by the international environment in the adjustment process in the developing countries.

Although it was a middle-income developing country with a relatively strong economy, Mr. Wang noted, Brazil had suffered from the heavy burden of the large volume of foreign commercial loans. In the future the developing countries could not continue to rely on commercial loans to the same extent as in the past. Developing countries needed access to private markets, but adequate attention had to be paid to the domestic economic realities of individual countries and to the possibilities for obtaining financial assistance from other public sources.

Mr. Sangare said that he agreed with previous speakers that the Brazilian authorities were to be commended for the efforts that they had made to strengthen the economy. Significant improvements were expected in 1981: real GDP was projected to grow at a positive rate, despite the 5 per cent decline in industrial output in the first seven months of the year; the inflation rate, although high by international standards, was declining; the balance of payments position had strengthened; and the decline in the level of reserves had been halted. The favorable developments seemed to be the result of the adjustment policies that the Government had adopted since late 1980 and under which priority had been given to improving the external position, reducing inflation, and improving both the allocation of resources and the efficiency of their use.

On the fiscal front, Mr. Sangare continued, the decisions increasing the buoyancy of the income tax and improving the tax administration were steps in the right direction. The authorities were to be commended for their effort to tighten public spending, particularly that of the state enterprises, but he agreed with the staff that more attention should be paid to that area; spending in 1981 was likely to exceed original expectations, thereby increasing the difficulty in controlling inflation in Brazil. The present wage policy, which tied wage adjustments to the rate of inflation in the previous period, also added to the difficulty in controlling inflation.

In the monetary field, Mr. Sangare said, the authorities' attempts to reduce the demand for credit appeared to have been consistent with their objective of controlling aggregate demand. The rise in interest rates had restricted the demand for credit and had encouraged savings, but a large portion of loans continued to be made at subsidized interest rates.

In order to improve the balance of payments, the authorities should be encouraged to maintain their efforts to reduce Brazil's dependence on imported oil, Mr. Sangare considered. The steps that were being taken to ensure the competitiveness of Brazilian exports, including modifications in the exchange rate, were essential, especially in the light of the high rate of inflation in Brazil. As for the external debt, Brazil had maintained its credibility in the international capital markets, but the heavy interest payments in recent years suggested that the situation should be kept under continuous review.

Mr. Kharmawan commented that in 1973-74 and 1978-79 factors beyond the control of the authorities had interrupted the spectacular record of economic growth in Brazil; the oil import bill had soared, and there had been a corresponding deterioration in the balance of payments. The authorities' initial response had not been fully successful, but the additional measures that had been introduced late in 1980 and early in 1981 had quickly improved the balance of payments. The new policies had included measures in the fields of demand management and supply, and many of the subsidies and restrictions had been eliminated. In the past, the authorities had consistently been willing to adjust the exchange rate to inflation and to increase wages in line with the cost of living index. More recently, the authorities had introduced a kind of crawling peg and had taken steps to avoid excessive increases in real wages. The new set of measures was courageous, and the effects had been even more beneficial than had been anticipated; the trade balance, for instance, had become positive, after a long period of deficits. The price that inevitably had to be paid for the new measures--a slowing of the rate of economic growth--seemed to be temporary in nature.

The management of Brazil's economy was unusual, Mr. Kharmawan continued; although the economy was clearly a mixed one, the authorities had consistently had the courage to maintain a policy stance designed to encourage high rates of economic growth while accepting the inevitable consequences of relatively rapid rates of inflation. Nevertheless, the authorities had made a determined effort to limit the rate of inflation, and they had been somewhat successful; but the prospects for substantially reducing the rate were not promising. It would be useful to have further comments on the likely rate of inflation in the coming years as a result of the new policy stance.

The high interest rates abroad had clearly had a significant impact on Brazil's foreign debt, Mr. Kharmawan remarked. An increase of 1 percentage point in the interest rate on Brazil's debt added $400 million to its debt service burden. The Executive Board had often spoken of the adverse effect of the increases in oil prices, and the time was ripe for the staff to study the adverse impact of high international interest rates on the economies of developed and developing member countries. To some extent, the effects of high interest rates were even more pervasive than the effects of oil price increases.

The case of Brazil naturally raised the question of how long a country could continue to rely on foreign borrowing to bolster its balance of payments and to achieve a relatively high rate of economic growth, Mr. Kharmawan commented. The Government's policy stance had clearly been designed primarily to achieve high rates of growth and, in that context, it had been quite successful. Still, he wondered why the authorities preferred foreign borrowing to direct foreign investment, especially as the latter would be far less burdensome on the balance of payments. Finally, the outlook for the Brazilian economy was difficult to determine, in large part because of the unique system of economic management.

Mr. Kannangara noted that Brazil had achieved high rates of economic growth until the early 1970s. Since then, it had recorded rates that were significant--although low by historical standards--despite high rates of inflation and balance of payments deficits. In 1980, real GDP had grown by 8 per cent, compared with 6.5 per cent in 1979, and the upward trend was expected to continue in the coming period. The recovery from the slippages that had occurred was attributable to the prudent policies that the authorities had adopted in response to the changes in economic conditions; they had increased overall efficiency by using an appropriate mix of demand management and supply-oriented policies.

Brazil had maintained a sound energy policy, Mr. Kannangara commented, and its development of oil resources and its conservation efforts had lessened its dependence on imported oil; only 70 per cent of net consumption needs were met by oil imports. Given the large size of the oil import bill in the past, the new energy measures should make a significant contribution to improving the balance of payments position. The Government had also been successful in developing hydroelectricity, the potential for which was vast. In addition, Brazil was the leader in the development of an alcohol-based energy program; other developing countries had followed the program with interest, and it was regrettable that it might be set back by the decline in the demand for cars powered by alcohol-based fuel.

There had been a considerable improvement in Brazil's external position in recent months, Mr. Kannangara noted. A small trade surplus was estimated for 1981, and the size of the surplus was likely to triple in 1982. The staff had attributed that favorable development to the considerable adjustment effort that the authorities had made and to their willingness to accept an increase in the cost of foreign borrowing. Despite the present unfavorable state of the world economy, Brazilian exporters had been able to achieve a substantial increase in exports by penetrating new markets and by offering new high-technology products. Their export performance reflected the effectiveness of the various trade and exchange rate policies that the authorities had introduced.

Brazil's success in achieving a high rate of economic growth, improving the energy sector, and expanding exports was the result of the considerable stepping up of investment in the country, Mr. Kannangara considered. The authorities had resorted to substantial foreign borrowing to increase the investment effort to a larger extent than would have been possible otherwise. As long as the resources were used productively, they should lead to the eventual strengthening of the economy. He endorsed the staff's conclusions and accepted the proposed decision.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/139 (11/9/81) and EBM/81/140 (11/13/81).

4. NIGER - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/292 (11/5/81). 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 postpone its consideration of the 1981 Article IV consultation with Niger until not later than December 21, 1981.

Decision No. 6984-(81/140), adopted November 9, 1981

5. UPPER VOLTA - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/291 (11/5/81). 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 postpone its consideration of the 1981 Article IV consultation with Upper Volta until not later than December 16, 1981.

Decision No. 6985-(81/140), adopted November 9, 1981

6. STAFF TRAVEL ALLOWANCES

1. Effective from November 1, 1981, the revised rates under the three-tier system of staff per night allowances will be as follows:

New Rates Applicable to Countries Listed in	Standard Rates		
	Hotel	Subsistence	Total
Attachment I	$75	$50	$125
Attachment II	$55	$40	$ 95
All other countries	$45	$40	$ 85

When the hotel rate and the subsistence rate are exceeded, reasonable actual cost will be reimbursed on the basis of itemized receipts or other similar documentary evidence or supporting information. In cases where only one of the two elements (hotel room or subsistence) is in excess of the standard amount, that element will be reimbursed on the basis of reasonable actual cost and the other element will be reimbursed on the basis of the standard allowance.

2. Effective from November 1, 1981, the in-and-out allowance for staff is raised from $20 to $28, including a new standard provision for coverage of airport taxes.

3. Effective from December 1, 1981, a lump sum for travel expenses en route from Washington to the first official destination and en route from the last official destination to Washington will be paid in lieu of subsistence, hotel, and in-and-out expenses. This lump sum will consist of the standard rate of $125 together with an in-and-out allowance of $28 payable for each authorized stopover between Washington and the first and last official destination on a trip. The lump sum will only be paid for authorized stopovers when there is specific evidence that they have been taken. Expenses incurred at the mission site and on travel from one mission site to another will continue to be reimbursed on the basis of the rates applicable for each country stayed in. (EBAP/81/354, 11/5/81)

Adopted November 12, 1981

7. COORDINATION OF HOME LEAVE BENEFITS

With effect from November 1, 1981, Fund staff members eligible for home leave who are married to one another and who have different home leave destinations shall be permitted to travel with their children to both destinations on a circular trip once every two or three years at the Fund's expense. (EBAP/81/352, 11/4/81; and Correction 1, 11/5/81).

Adopted November 12, 1981

8. RELATIONS WITH GATT - CONSULTATION WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves Fund guidance at the GATT meeting to be held in Geneva as set forth in EBD/81/276, Supplement 1 (11/9/81).

Decision No. 6986-(81/140), adopted
November 12, 1981

9. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/84 through 81/88 are approved. (EBD/81/288, 11/4/81)

Adopted November 10, 1981

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

Travel by Executive Directors as set forth in EBAP/81/357 (11/10/81) and EBAP/81/358 (11/10/81) is approved.

APPROVED: March 29, 1982

LEO VAN HOUTVEN
Secretary

Countries for which Standard Allowance of $125
($75 for hotel and $50 for subsistence) is Proposed

1. Algeria
2. Argentina
3. Australia
4. Austria
5. Bahamas
6. Bahrain
7. Barbados
8. Belgium
9. Belize
10. Brazil
11. Burundi
12. Cameroon
13. Canada
14. Chile
15. Congo, People's Republic of
16. Denmark
17. Dominican Republic
18. Fiji
19. Finland
20. France
21. Gabon
22. Germany
23. Ghana
24. Greece
25. Guinea
26. Hong Kong
27. India
28. Iraq
29. Israel
30. Italy
31. Ivory Coast
32. Jamaica
33. Japan
34. Kenya
35. Kuwait
36. Lebanon
37. Liberia
38. Mali
39. Mexico
40. Netherlands
41. Netherlands Antilles
42. Nigeria
43. Oman
44. Pakistan
45. Panama
46. Papua New Guinea
47. Peru
48. Philippines
49. Romania
50. Saudi Arabia
51. Senegal
52. Seychelles
53. Sierra Leone
54. Singapore
55. Spain
56. Sudan
57. Sweden
58. Switzerland
59. Syrian Arab Republic
60. Thailand
61. Togo
62. Trinidad and Tobago
63. Tunisia
64. United Arab Emirates
65. United Kingdom
66. United States
67. Venezuela
68. Yemen Arab Republic
69. Zaire

ATTACHMENT II

Countries for which Standard Allowance of $95
($55 for hotel and $40 for subsistence) is Proposed

1. Afghanistan
2. Central African Republic
3. Colombia
4. Cyprus
5. Egypt
6. Gambia, The
7. Grenada
8. Guinea-Bissau
9. Guyana
10. Haiti
11. Indonesia
12. Iran
13. Ireland
14. Jordan
15. Korea
16. Luxembourg
17. Maldives
18. Malta
19. Mauritania
20. Montserrat
21. Morocco
22. New Zealand
23. Niger
24. Norway
25. Portugal
26. Qatar
27. Sri Lanka
28. St. Vincent
29. Suriname
30. Tanzania
31. Turkey
32. Upper Volta
33. Yemen, People's Dem. Rep.
34. Yugoslavia
35. Zambia
36. Zimbabwe