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R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	Zhang Z.
	C. S. Warner
	G. P. Alzetta, Temporary
E. T. El Kogali	L. B. Monyake
E. V. Feldman	R. J. Lombardo
L. Filardo	
R. Filosa	N. Kyriazidis
M. Finaish	A. M. Othman
M. R. Ghasimi	O. Kabbaj
G. Grosche	
J. E. Ismael	E. Kiriwat
B. Jalan	L. E. N. Fernando
A. Kafka	L. M. Piantini
	J. R. N. Almeida, Temporary
M. Massé	D. McCormack
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
J. Ovi	
H. Ploix	
G. A. Posthumus	G. P. J. Hogeweg
	C.-Y. Lim
K. Yamazaki	S. Yoshikuni

J. W. Lang, Jr., Acting Secretary
M. Primorac, Assistant

Also Present

L. H. Landriault, Executive Secretary, Joint Bank/Fund Committee of Executive Directors on Staff Compensation. IBRD: D. Bock, Director, Debt Management and Financial Advisory Services Department. Office of Executive Director: R. Myers, Advisor. Administration Department: G. F. Rea, Director; D. A. Anderson, T. Cole, D. S. Cutler, A. D. Goltz, P. D. Swain, L. A. Wolfe. African Department: M. Touré, Counsellor and Director; P. Dhonte. European Department: M. Guitián, Deputy Director; D. Ripley. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; M. Allen, S. B. Brown, E. Brau, A. Chopra, M. G. Kuhn, J. P. Pujol, K. P. Regling, B. C. Stuart, C. M. Watson. External Relations Department: H. P. Puentes. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; P. L. Francotte, J. S. Powers. Research Department: J. A. Frenkel, Counsellor and Director; M. Goldstein, Deputy Director; G. Calvo, M. P. Dooley, R. D. Haas. Secretary's Department: A. P. Bhagwat, S. L. Yeager. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; O. Roncesvalles, G. Wittich. Western Hemisphere Department: S. T. Beza, Director; J. Ferrán, Deputy Director. Advisors to Executive Directors: M. Al-Jasser, F. E. R. Alfiler, M. B. Chatah, P. O. Montórfano, P. D. Péroz. Assistants to Executive Directors: S. Appetiti, H. S. Binay, G. Bindley-Taylor, E. C. Demaestri, Di W., S. K. Fayyad, M. E. Hansen, M. Hepp, J. Heywood, A. Iljas, V. K. Malhotra, J. K. Orleans-Lindsay, A. Rieffel, S. Rouai, C. C. A. van den Berg.

1. DEBT STRATEGY AND SITUATION - WORK IN PROGRESS

The Executive Directors discussed the drafts, as outlined by the staff, of three forthcoming staff papers on issues relating to debt. The first paper dealt with circumstances and financing approaches related to the debt situation, the second dealt with preliminary considerations regarding Fund support for debt reduction operations, and the third dealt with the Fund's policy on financing assurances.

The Economic Counsellor and Director of the Research Department indicated that the first paper, on country circumstances and financing approaches related to the debt situation, 1/ provided a background to the more specific operational issues that were dealt with in the other two papers. The objective of the debt strategy was a return to economic growth and normal access to credit markets for debtor countries. Any specific considerations had to be measured against that overriding objective. Debt and debt service reduction in the context of a strong growth-oriented adjustment program would contribute to the objective.

Eligibility for Fund support for debt reduction would have to be determined on a case-by-case basis rather than according to uniform quantitative criteria, the Economic Counsellor remarked. The following conditions would have to be met: the implementation of a strong, consistent economic program and a judgment that debt reduction operations would be useful in restoring a country's economic viability and would represent an efficient use of scarce resources. The paper would need to clarify the appropriate criteria, and the staff would welcome Directors' guidance in that matter.

The paper considered the appropriateness of the medium-term framework to assess the impact of debt reduction operations, the Economic Counsellor continued. While there were drawbacks to medium-term scenarios, primarily owing to the uncertainty or analytical problems surrounding projections, the staff's view was that since debt reduction focused on the restoration of medium-term viability, medium-term scenarios provided the most useful guide. In designing the scenarios, the question of how debt or debt service reduction contributed to growth and to improved policymaking would have to be addressed.

The amount of debt reduction that would take place obviously depended on the funding that was available for such operations, the Economic Counsellor remarked. The paper would investigate the degree of leverage that could be achieved through the use of various debt reduction schemes. Of course, certain considerations, such as cash flow implications, would guide debtors and creditors in choosing among such schemes. Debtors should be free to explore different options--including debt buy-backs, exchanges of old debt for enhanced new debt, and debt-equity conversions--with their creditors. For their part, creditors would not be forced to

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1/ See EBS/89/77 (4/19/89).

accept debt reduction instruments at exchange ratios that did not reflect the market value of existing claims. A possible additional source of financing for debt reduction operations was the debtor country's own reserves when its economic growth performance exceeded targets. For debt reduction operations to proceed, a waiver of certain clauses under existing loan contracts would generally be required, and the nature of the waivers would be determined through negotiations. In any case, new money would be an essential part of the new financing packages to be negotiated between the commercial banks and debtor countries. In that context, the role of the Fund might be to monitor such negotiations.

While current debt discussions focused on the market-traded debt of the middle-income countries, the needs of lower-income countries and those countries which had managed their economies well--the so-called forgotten countries--would also have to be addressed, the Economic Counsellor commented.

The Director of the Exchange and Trade Relations Department remarked that a special effort by the Fund to assist countries in especially difficult circumstances would in no way infringe on the principle of uniformity of treatment among members. Special efforts to meet particular situations had been undertaken a number of times in the Fund's history. But there could be a risk that a special effort by the international community to encourage debt reduction on behalf of the middle-income countries could divert resources from other countries that were in need of traditional forms of assistance. It was essential that that not be allowed to occur.

There were arguments for and against prejudging the amount of debt reduction that was necessary for such operations to be effective, the Director continued. While medium-term scenarios would be useful, they had well-known weaknesses. Experience suggested that the picture they gave was reasonably valid for the first two years, but thereafter the figuring was largely obtained by simple extrapolation. Another weakness was that assumptions regarding the course of such variables as interest rate and oil prices were not changed between one year and another.

In the paper on preliminary considerations regarding Fund support for debt reduction operations, 1/ it was envisaged that strong macroeconomic programs would be an essential prerequisite for Fund support, the Director commented. Staffs of both the Bank and the Fund would need to work together closely in order to ensure consistency in their approach to policy adjustment. The modalities that would need to be adopted by the two institutions for support of debt reduction might give rise to additional operational questions. For example, would an extended arrangement or stand-by arrangement be the more appropriate instrument for providing financial support for debt reduction operations? In that regard, it had to be kept in mind that negotiations between the debtor country and its

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1/ See EBS/89/78 (4/19/89).

commercial bank creditors on debt reduction might be lengthy and might even exceed the duration of a one-year stand-by arrangement. In any event, the Fund clearly could not provide enough debt reduction support to affect significantly the debt position of many middle-income countries, and its contribution would have to be viewed as primarily catalytic. Fund support might also be considered in the context of enhanced structural adjustment arrangements, but the specific modalities of such an approach would have to be dealt with separately.

Another question was how the Fund would deal with waivers, the Director observed. The banking community would decide whether waivers of restrictive clauses in lending agreements were to be partial or general, and whether they might be granted contingent upon the successful implementation of an economic program supported by a Fund arrangement. The Fund would have an interest in ensuring that the waivers granted were adequate for the magnitude of debt reduction that might be deemed necessary.

The type of debt reduction most emphasized in the Interim Committee's recent communiqué was the setting aside of a specified portion of the member's access to the resources of the Fund for the purpose of debt reduction, particularly cash buy-backs, the Director recalled. As regards the phasing of Fund disbursements in support of debt reduction, the prudent approach seemed to be to work toward an even phasing, contingent upon the fulfillment of performance criteria. However, if a program was front-loaded, there was an argument for also front-loading Fund disbursements. Another possibility would be to allow the country to select a degree of flexibility in choosing the most appropriate phasing; for example, actual disbursements might coincide with approved debt reduction operations.

Another issue was whether the Fund should make its resources available to finance buy-back operations subject to a determination that the terms and amounts of the buy-back met certain requirements, the Director remarked. This raised the issue as to whether, when the Fund reviewed the use of its resources, it could then decide that the buy-back had taken place at an insufficient discount. Such a finding seemed difficult to envisage, but some sort of review was important if disbursements were not to become a mere formality. In addition, it would be necessary for the Fund to remain fully informed.

The Interim Committee had also requested an examination of the possibility of providing resources for limited support of interest payments, the Director recalled. Securitization of debt service payments could be effected in a number of ways including in the form of guarantees from a third party. The paper rejected that approach for a number of reasons, most obviously because under the Fund's Articles of Agreement, the Fund did not have power to give guarantees.

An alternative would be to use the debtor country's own resources to help secure debt service payments, which would avoid the complications associated with guarantees of a third party, the Director continued.

Those resources placed as collateral could be deposited to a Fund-administered account so as to convince creditors of the improved quality of their claims. That approach raised several issues, including, among others, the conditions of access, the level of liquidity necessary to maintain those accounts, the appropriate charges, the possibility of investing the resources to partially offset the costs of administration while ensuring that the resources could be made available virtually instantaneously, and the amount of leverage that could be obtained through collateralization.

Collateralization also raised other questions, the Director noted. For example, what would happen to an escrow account if the program was substantially off course, or when the program was ended? What would happen if a country receiving interest payment support from the Fund were in arrears at the time when it used the resources; would the Fund's disbursements be available used to supplement interest payments to the banks but not to the Fund? If the resources of individual debtor countries were pooled in a single account, would that provide further leveraging for securing a larger amount of interest payments? But then there could be difficulties if one country called in the guarantee, leaving the other countries less than fully covered. There was also the risk of a run on a pooled account owing to a systemic deterioration in the external economic environment, such as rising interest rates or a decline in the volume of world trade.

The paper on the Fund's policy regarding financing assurances 1/ reviewed experience with that policy and suggested adaptations that seemed to be needed in the current circumstances, the Director remarked. The objectives of the Fund's policy on financing assurances was to ensure that a program was adequately supported and that the Fund's resources were used as a catalyst to mobilize other sources of financing as necessary. It was interesting to note that the critical mass policy had never been strictly adhered to. Between 1982 and 1987, the policy had been fully applied only to one half of the possible cases, and in about one half of those cases, the Board had taken a decision to approve the program before the critical mass of financing had finally been achieved. In addition, since 1982 the Board had with increasing frequency been satisfied with commitments for lower minimum amounts covering shorter periods. The Board had reviewed and modified its policy on financing assurances on a number of occasions to meet changing circumstances. For example, the question had arisen when banks had been reluctant to agree on financing packages for a number of small and medium-sized countries--for reasons unrelated to the country's situation--and the Fund had found itself hampered in supporting a member's program at a time when it was most advantageous, economically and politically, to launch the program. With the introduction of debt reduction strategies, the likelihood of long, drawn-out discussions between countries and the banks meant that delays in program implementation were likely for larger countries as well.

1/ See EBS/89/79 (4/20/89).

The Fund had tentatively been moving toward making disbursements before financing assurances were in place, and that practice would have to continue in the new circumstances if the Fund was to be able to support members' economic programs, the Director observed. That practice gave rise to a number of questions. For example, a decision had to be made on the timing of program reviews and the conditions under which disbursements should continue. The paper would also examine how to avoid the possibility of the Fund's resources being used to service the claims of other creditors.

With respect to a possible buildup of arrears, the paper took the position that if the Fund did nothing on that front, the buildup in the arrears position could be massive and disorderly, affecting all creditors, the Director commented. Accordingly, the basic task at hand was to keep an inherently disorderly situation as orderly as possible in the circumstances. Arrears could be divided into two categories: the portion representing interest due to the banks that could only be met by new lending or debt reduction; and that portion which could be expected to continue to be serviced, given the country's balance of payments prospects. It would have to be decided whether the latter portion should indeed be fully serviced or whether the country should in some circumstances be permitted to retain resources equivalent to those debt service obligations with those resources being safeguarded by an equivalent addition to the reserve target of the program or by placing them in an escrow account. Difficulties, of course, would arise if performance criteria were not met or if the Fund-supported program ended.

The paper would also look at such issues as the desirability of some form of burden sharing between various creditors, the importance of safeguarding trade finance or interbank lines, the possibility of accusations of bad faith in the negotiating process, and the risks to the Fund that were inevitably inherent in a financing assurances policy, the Director of the Exchange and Trade Relations Department remarked. In essence, the paper would attempt to formulate a policy that continued to meet the original objectives of the Fund's policy on financing assurances, but in different circumstances.

Mr. Enoch asked whether the technicalities and alternative forms of waivers would be studied in the papers. He was concerned that some proposals being made regarding general waivers were too ambitious. Was there any ongoing discussion with the banks regarding their attitudes toward waivers?

The Director of the Exchange and Trade Relations Department said that while the subject of waivers would have to be dealt with, it was not fully covered in any of the three papers. The questions raised by Mr. Enoch were being explored by the staff with the staff of the World Bank. There had not been any contacts between the Fund staff and the commercial banks.

Mr. Almeida asked whether experience with the various menu items considered in the staff paper on methodological considerations and policy issues related to comparing menu items (EBS/88/261, 12/20/88) would be discussed in the forthcoming papers.

The Economic Counsellor noted that when discussing the framework for the staff's work, the Board had suggested that the three papers should be relatively brief, with no specific illustrations.

Mr. Lim recalled that the Director of the Exchange and Trade Relations Department had mentioned the possibility of using the resources of the enhanced structural adjustment facility to support debt reduction operations. What was the rationale for that approach? Also, was it possible for the Board to change the character of that facility without the approval of governments?

The Director of the Exchange and Trade Relations Department said that there were indeed difficulties inherent in using the resources of the enhanced structural adjustment facility to support debt reduction operations. Whether a basic change requiring consultation with contributors would be needed was not yet certain.

The Acting Chairman explained that because some countries using the resources of the enhanced structural adjustment facility had commercial debt claims, it was important to examine the possible use of that facility to address their debt problem rather than exclude that possibility a priori. The proposal was being considered in that spirit.

Mr. Lim suggested that since the use of the enhanced structural adjustment facility for debt reduction operations was an important issue, it should be examined separately rather than as part of the debt strategy.

The Acting Chairman remarked that the staff papers would not put forth proposals but rather would identify the issues involved. Those issues involving the enhanced structural adjustment facility would have to be considered at a later time in the context of a discussion on that facility.

Mr. Jalan stressed that the eligibility of countries for Fund support for debt reduction operations should be based on objective criteria that took into account individual countries' circumstances and behavior rather than quantitative considerations such as the actual discount at which debt was traded. Measuring the debt discount, instead of, for example, the burden of debt, would simply encourage countries to induce discounts by withholding payments on their debt. On the link between Fund disbursements and performance criteria, he noted that the Fund's support of debt reduction operations differed from other Fund facilities because the assurance of Fund financing and debt reduction was expected to catalyze further resources. Any uncertainty regarding the availability of Fund resources for the anticipated amount of debt reduction would hamper a member's negotiations with the banks, who would be monitoring the member's performance. Moreover, there would have to be a certain amount of front-loading to facilitate the banks' participation. Similarly, the conditionality usually attached to Fund financing would have to be modified somewhat. Finally, on financing assurances, he approved of the flexibility of the Fund's policy in the past; that approach should now be formalized in the context of debt reduction as a general policy applicable to all Fund arrangements and not only those having a debt reduction component.

The Economic Counsellor said that he was in full agreement with Mr. Jalan on the need for objective criteria. Indeed, the first criterion would be the existence of a strong and consistent economic policy program. Moreover, the policies being undertaken would have to be beneficial in restoring access to credit markets. In that context, the moral hazard of a country trying to drive down the market value of its debt so as to benefit from debt reduction operations would not be judged as meeting that criterion. There would also need to be a rigorous and quantitative analysis of the rates of return of the various operations. The criteria would not, however, consist of a formal list of benchmarks and specific targets.

On the use of medium-term scenarios, the Economic Counsellor observed that five-year projections could not be utilized with great confidence. Accordingly, as medium-term projections were carried out, the focus should shift from an accounting of available resources to the incentives offered by releasing such resources, including whether those incentives would be conducive to growth, investment, and saving. Those were the only meaningful criteria when examining medium-term growth performance.

The Director of the Exchange and Trade Relations Department said that while he understood the thought lying behind Mr. Jalan's second point on conditionality, the staff's preliminary view was that the country's performance in regard to economic policies was a fundamental criterion. On financing assurances, it was not clear that it would be advisable to change the Fund's policies completely. Instead, the approach that the Fund had been following remained valid where it could still be applied; however, the number of instances where it could not be applied had been increasing and was likely to increase further. Therefore, agreement was necessary on the approach to be taken when the formulas currently being used were no longer applicable.

Mr. Posthumus said that he was somewhat concerned that the staff was predicting a substantially increased use of the extended Fund facility, yet was skeptical about the usefulness of its medium-term scenarios. The Fund's role in financing debt reduction operations was only responsible if the amount of debt reduction achieved was sufficiently large to put the economy back on track. It was therefore necessary to estimate the extent of debt reduction; otherwise, the Fund would be assuming the banks' risk. The Fund should have the opportunity at various stages to review its financing of debt reduction operations.

The Economic Counsellor observed that while the staff's confidence in medium-term scenarios was limited, it held the view that such scenarios were the best available technique for a meaningful analysis of medium-term prospects.

Mr. Warner asked whether it was envisaged that a certain percentage of financing under an arrangement with the Fund would be used for debt reduction. In his view, some record of how funds were used should be maintained.

The Director of the Exchange and Trade Relations Department said that there would be a need for some review process. Of course, the funds could be disbursed a number of ways. For example, they could be disbursed on a normal phasing basis, leaving it to the member country to use the funds in the way it felt was most suitable for debt reduction, which was the market approach. That assumed that waivers would be given in sufficient time and in sufficient scope for the funds to be used. Another approach could be a cumulative entitlement, which could be disbursed when the waivers were agreed. The paper would investigate the various options.

Mr. Warner remarked that it would be useful to adjust operational procedures as requests came before the Board and in the light of experience with debt reduction.

The Director of the Exchange and Trade Relations Department said that management and the staff viewed debt reduction as a reiterative process, whereby some principles would be established at the outset but would be applied flexibly to allow for debt reduction operations to be carried out in the most effective and timely manner.

In response to a question by Mr. Warner, the Director remarked that the paper on Fund support for debt reduction included a section on capital flight. Clearly, it was desirable to prevent capital flight, but the difficulty was finding an approach that achieved that objective. The paper would look at the possibility of drawing on the experience of a number of countries in attracting workers' and immigrants' remittances. Other countries had managed to give special inducements to the repatriation of flight capital for specific purposes, by guaranteeing the owner's right to retransfer the capital abroad. The options had to be judged in the light of their effectiveness and of the problems to which they could give rise.

The most powerful instruments for inducing a return of flight capital were appropriate exchange rate and monetary policies pursued over time, the Director of the Exchange and Trade Relations Department noted. With regard to foreign direct investment, the Fund staff hoped to draw on the World Bank's expertise in that area and incorporate such investment, as required, in the Fund's approach to debt reduction.

Mr. Warner observed that the global issue of foreign direct investment was more a concern for the World Bank than for the Fund. However, in establishing the best possible medium-term outlook for growth, the inclusion in programs of guidelines on foreign direct investment would be welcome.

In another matter, he wished to note the concern expressed by commercial banks that the Fund should not become too directly involved in negotiations between debtors and commercial banks, Mr. Warner commented.

Mr. Yamazaki asked whether the papers dealt with the encouragement of direct investment or with debt-equity swaps.

The Economic Counsellor said that the paper on country circumstances and financing approaches addressed the specific forms that debt reduction operations could take, and in that context, the techniques mentioned by Mr. Yamazaki were examined. The overriding consideration was which mechanisms were conducive to the restoration of growth and access to capital markets. Those were the mechanisms that would attract capital reflows as well as direct investment.

Mr. Ismael said that he fully supported Mr. Jalan's view that eligibility should be based on objective criteria. The debt problems of the "forgotten countries" could not be solved through structural or enhanced structural arrangements, because not all of those countries were eligible to use those facilities. Nor could their problems be solved through debt buy-backs or other market instruments, since their debt did not trade at a discount. Thus, other devices had to be invented to help alleviate the debt problem of these "forgotten countries."

Mr. Jalan, commenting further on the content of programs, said he questioned whether there ought to be a relationship between the Fund's disbursements in support of debt reduction operations and the performance criteria for the subsequent period. For example, if debt reduction on the order of 20 percent was required in order to give confidence to the commercial banks and if that amount of debt reduction could be achieved through a Fund program totaling $1 billion, and disbursements were phased over a three-year period, the achievement of the envisaged level of debt reduction over that period would be contingent upon fulfillment of certain performance criteria. Various factors, however, could impede the achievement of those criteria, which would lead to some uncertainty on the part of the commercial banks, which in turn might affect the commercial banks' willingness to provide fresh money in the volumes necessary to support investment and growth.

The Director of the Exchange and Trade Relations Department remarked that a contingency element would be required if disbursements were to follow the usual phasing attached to the usual conditions. However, the alternatives raised other difficulties. He had understood from the Interim Committee communiqué that Ministers concluded that traditional phasing would be appropriate for countries with particularly strong programs. He did not consider that Fund financing would be a contingent element directly affecting the banks' decision on whether to grant a waiver. It had always been stressed that the Fund's financial contribution should be catalytic, because its resources alone were not sufficient to have a significant impact on debt reduction operations. Accordingly, other resources would have to be made available and might also be disbursed more rapidly. For example, World Bank lending was not phased in the same way as Fund lending, but was usually more front-loaded.

Mrs. Filardo said that the positive and negative implications of debt reduction instruments for each country had to be examined. For example, debt-equity swaps could be beneficial for commercial banks, but not for the country itself. She was concerned that the inclusion of capital repatriation in the medium-term scenarios could become a constraint in the program if the envisaged level of repatriation could not be accomplished. Accordingly, she would suggest that that instrument should be an alternative for debt reduction only in the event of overperformance.

She would welcome some elaboration from the Economic Counsellor on eligibility for Fund support for debt reduction, Mrs. Filardo continued. Specifically, he had mentioned that eligibility would depend largely on the strength of the program and the consistency of performance. He had also stated that the amount of debt reduction would depend largely on the funding available. How did the staff view the position of countries whose medium-term scenario revealed that there was a large debt overhang and had a great need for debt reduction, but which did not have the resources available to conduct debt reduction operations.

She supported Mr. Ismael's view regarding countries which had no commercial bank debt but were in arrears to other creditors, for example, to the Bank and the Fund, Mrs. Filardo commented. Those countries could adopt policies to correct their arrears problem, but if the resources required to support their programs were not forthcoming, their efforts would be futile and their debt problems would not be alleviated.

The Economic Counsellor said that Mrs. Filardo had noted the potential difficulties that could arise from debt-equity conversions and had questioned their general use. The paper would point out that a debt-equity conversion of public sector liabilities was, in essence, a replacement of external debt by domestic debt at a negotiated rate. There was a risk that such a replacement could contribute to inflationary pressures, among other problems. Countries with strong fiscal positions and broad domestic financial markets would be less likely to encounter such dangers. In any event, a case-by-case assessment of whether the conversion could be absorbed without significant changes in monetary expansion would be required.

The Director of the Exchange and Trade Relations Department remarked that banks might deal with the problem raised by Mrs. Filardo by making debt reduction operations conditional upon an equity right, which could be exercised if the country's performance was significantly better than had been envisaged at the time when the agreement was negotiated. That approach might make the banks more amenable to debt reduction because they would be at less of a disadvantage if they sold their claims at a price that, in a few years' time, appeared too low to their shareholders. Such overperformance could be due to a return of flight capital on a scale that had not been foreseen, or to a sharp rise in the price of a primary commodity export, for example. He expected that the banking community would develop creative solutions when entering into negotiations.

On eligibility, a strong economic program was clearly a prerequisite, but a quantitative assessment of the market response to debt reduction would also be necessary, the Director of the Exchange and Trade Relations Department observed.

Mr. Yamazaki remarked that he had emphasized debt-equity swaps, new flows of capital, and reflows of flight capital because of their importance to the debtor country, not the commercial banks. While there were arguments against debt-equity swaps because of their possible inflationary impact, arguments regarding the positive implications of such swaps for economic growth were equally valid.

The Acting Chairman, in response to a question by Mr. Yamazaki, said that the three papers would be circulated in the following week, and an informal discussion on the basis of those papers could take place in early May.

Mr. Yamazaki said that his authorities would welcome a meeting as early as possible.

Mr. Enoch remarked that it might be helpful to divide the discussion of the papers into more than one session.

The Director of the Exchange and Trade Relations Department commented that it might be appropriate to discuss financing assurances separately from the other two topics.

Mr. Grosche said that he was impressed by the outline of the staff papers and would welcome an informal discussion on debt reduction operations on the basis of the refined papers.

He agreed with Mr. Posthumus's observation regarding the limitations of medium-term scenarios, Mr. Grosche continued. However, he had understood the Director of the Exchange and Trade Relations Department as saying that it was desirable to base certain decisions, such as those on financing assurances, on the outcome of those scenarios. Either the staff had to convince the Board that it could have confidence in the scenarios, or it had to admit that they were not reliable enough to base policies upon them.

The Director of the Exchange and Trade Relations Department said that the staff had assumed in its scenarios that an agreement would be reached between the country and the banks within 12 months; consequently, financing assurances would only be projected for a 12-month period. It was always possible that, in the context of an extended arrangement, the country might not reach agreement with the banks until the second or third year of the arrangement, and in those circumstances, a pause for reflection would surely be called for.

In response to a question by Mrs. Ploix, the Director of the Exchange and Trade Relations Department remarked that the staff did have in mind possible alternatives for financing debt reduction operations, but the draft papers did not investigate all the suggestions that had been made in various forums.

Mr. Posthumus said that he considered the pace of work on debt reduction was proceeding rapidly; the current discussion was taking place less than two weeks after the Interim Committee's meetings. The Fund had to wait for members to embark on strong adjustment programs and for commercial banks and creditor governments to move forward also. While he agreed that the Fund should not fall behind in its work, it did have to move in conjunction with the other players.

The Director of the Exchange and Trade Relations Department, in response to a comment by Mr. Lim, agreed that financing issues were important, but noted that the papers concentrated on the Fund's role. The World Bank's work on debt problems was moving in tandem, and the staffs of the two institutions were exchanging information regularly, which would be submitted to Executive Directors. The availability of resources from other sources was not yet clear, but he personally felt that the desired amount of debt reduction for those countries with meaningful programs could not be accomplished through the resources of the Fund alone.

The Economic Counsellor added that the papers under discussion were only preliminary studies. Some of the proposals made by Directors, including the French proposal, had been discussed in earlier staff papers. Admittedly, the proposals themselves were evolving over time, and would have to be examined as developments warranted.

Mr. Lim remarked that the issue of quotas was closely related to the Fund's role in support of debt reduction. While some senior U.S. officials had commented, in effect, that the Fund had enough resources to support debt reduction, other members had expressed different views. To avoid financing problems in the future, both issues--the quota increase and the Fund's role in the debt strategy--should receive due attention from the outset.

Mr. Finaish said that he was pleased that the papers would address the problems of other categories of debtors, particularly those with debts to official creditors. As the banks were obviously important players in debt reduction operations, it would be useful to have some information on their views regarding such operations.

The Acting Chairman commented that it was likely that the banks did not have a uniform viewpoint, and that their positions would be revealed in the course of individual negotiations. However, to the extent that the staff and management had contacts with the banks, their views would be conveyed to Directors.

Mr. Filosa remarked that the range of the three papers was large, so he hesitated to suggest additional topics. However, it was particularly important to examine tax legislation and waivers because of their direct bearing on the speed with which agreements could be reached between debtors and creditors as well as on the question of financing assurances. Also, an assessment of the amount of resources that would be needed for different debt reduction operations would be useful because of the impact of such variables on the availability of Fund resources and additional resources needed to finance members' program.

The Director of the Exchange and Trade Relations Department said that the staff agreed on the need for further work on the constraints of regulatory tax and accounting practices. The G-7 communiqué had indicated that those countries would be looking into that matter. As for a quantification of necessary resources, the staff was not able to make a reasonable estimate of the number of countries that would come forward with strong programs together with their debt overhang. In addition, it was not possible to know at what prices debt buy-backs could take place. The value of claims in the secondary market had moved sharply after the announcement of the U.S. Treasury Secretary's proposal, and further fluctuations could be expected in the future.

Mr. Ghasimi remarked that, on the question of eligibility, he associated himself with the points made by Mr. Finaish, Mr. Ismael, and Mr. Jalan. There were many indebted countries whose debts were not traded at a discount in the market but who could be eligible for debt reduction and the use of Fund resources. On another point, he agreed with the emphasis placed by the Director of the Exchange and Trade Relations Department on additionality in providing Fund resources for debt reduction. Would it be possible to have some estimate of the amount of resources that the Fund would be able to provide for debt reduction within the next three years without adversely affecting its traditional financing activities?

The Director of the Exchange and Trade Relations Department said that the amount of Fund resources available for debt reduction operations clearly depended on other demands in the coming years, on the repayment of the member's obligations to the Fund during that time, and on the availability and usability of the currencies included in the currency budget. The staff of the Treasurer's Department would be better qualified to respond more fully to that question.

The Executive Directors then adjourned their discussion on ongoing work on issues relating to the debt strategy.

2. JCC REPORT ON STAFF COMPENSATION - PRINCIPAL ELEMENTS OF PROPOSED COMPENSATION SYSTEM AND SALARY STRUCTURE

The Executive Directors considered a staff paper on the principal elements of the proposed compensation system and salary structure (EBAP/89/85, 3/30/89) and the consultants' report on the 1988 compensation survey (EBAP/89/85, Sup. 1, 4/3/89). They also had before them a paper prepared by the Staff Association Committee on the proposed compensation system and salary structure (EBAP/89/91, 4/5/89 and Sup. 1, 4/5/89).

Mr. Enoch made the following statement on behalf of Mr. Cassell:

> The JCC recommended that "...salary administration practices be geared to maintain average salaries within each grade close to the midpoint, i.e. to the desired relationship with the market....Expressed in technical terms the objective is to achieve a 'comparatio' of 100."
>
> This recommendation reflected the need to establish a control point that could be used to maintain the desired relationship to salaries in the comparator market at the chosen percentile level. However, the JCC also saw the target comparatio of 100 as one of several features of the proposed compensation system that would help to minimize the potential for conflict between the Fund and the Bank. The JCC Report noted that (page 56): "The proposed compensation system called for both institutions to maintain average salaries in each grade in line with the pay structure midpoints, thereby maintaining a comparatio of 100 in the Bank and the Fund."
>
> Both managements have endorsed the JCC's proposals on the target comparatio. In EBAP/89/85, Fund management asked the Fund's Executive Board to endorse the following recommendation (page 45): "The Bank and Fund should establish a pay policy relationship with the market by matching the midpoints of their salary ranges to the actual total cash compensation in the comparator market, at the selected percentile level, with the objective of maintaining average salaries at the comparatio of 100."
>
> Bank management expressed this recommendation more succinctly by seeking approval of the formula to be used in determining the overall pay increase (OPI) in 1989 and in future (page 25):

$$\mathrm{OPI} = \frac{100}{\mathrm{CR}} - 1 \times 100,$$

> where CR is the comparatio calculated by comparing the new salary structure with current salaries.

Recent informal discussions in the Bank and Fund Boards have suggested that the repercussions of following this recommendation may be wider than had previously been envisaged, and could be unhelpful in some directions.

The implication of this proposal is that the overall pay increase for Bank staff would be 12.7 percent, while that for Fund staff would be 7.5 percent. The difference is explained by two factors. First, the Fund's salary structure is, on average, about 3 percent above the Bank's salary structure. Thus, the increase in the salary structure required to bring existing midpoints into line with the new structure is lower in the case of the Fund than that of the Bank. Second, actual average salaries in the Fund are higher than in the Bank. Moreover, average salaries are higher relative to midpoints in the Fund than in the Bank. For higher level staff, the Fund's--unweighted--average comparatio is currently 107.5 compared with the Bank's average of 101.2.

While the first of these factors--the higher average salary structure in the Fund--would be eliminated when the new system was put in place on May 1, 1989, the second factor--the Fund's higher average comparatio--might continue under the new system. More specifically, while at the beginning of each salary year the comparatios of each institution would, under management's proposals, be brought up to 100, there might be institutional or demographic factors at work tending to push down the Bank's comparatio during the year by more than the Fund's comparatio falls. If this is indeed true, then each year Bank salaries would have to be increased by more than Fund salaries in order to bring the two institutions' comparatios into line at the target level of 100 at the start of the new salary year. Put simply, under the new salary system there would be a built-in tendency for Bank salaries to rise by more than Fund salaries.

In addition, the fact that the institutions' comparatios will tend to fall over the year from the target level of 100 implies that there would also be a systematic tendency for salaries in both the Fund and the Bank to rise by more than the market. This might not in fact mean that the Bank and Fund salaries for the average performer were moving ahead of the market, but it could certainly cause difficult presentational problems for the two institutions. And since the processes giving rise to this effect are not transparent, we need a fuller explanation of them from the two managements than we have had so far.

While slightly different pay adjustments in the two institutions from year to year might not be too troubling, I doubt that either of the Boards could find much justification for a salary system that systematically generated higher pay increases in one institution than in the other, and higher increases in both institutions than most implied by movements in the comparator markets. It is very important, therefore, that the managements work closely together to establish whether these are likely to be features of the new salary system.

Factors likely to influence the extent to which an institution's comparatio falls during the year will include: turnover rate--the higher an institution's turnover rate, the more its comparatio will fall during the year; promotion rate--the higher an institution's promotion rate, the more its comparatio will fall during the year; and manpower growth--the more rapidly an institution is growing, the more its comparatio will fall during the year. No comprehensive evidence is presented in either of the managements' papers on any of these issues.

There is now a pressing need for the Fund and Bank managements to establish what drives their respective institutions' comparatios. We clearly need a fuller justification for their recommended choice of a fixed target comparatio of 100 in each institution. Institutional and demographic factors may, in the event, point to the need for different comparatios in the Bank and the Fund, or for greater flexibility in setting the target from year to year.

At present it is very unclear whether the managements' proposal would enhance 'parallelism' in the two institutions. On the face of it, it could have the opposite effect.

The Director of Administration said that before turning to questions from Executive Directors, the staff would deal with the differences between the Bank and Fund proposals and the way in which the actual pay increase would be determined and distributed for the current year, and would provide some additional information on expatriation and other allowances. In addition, the staff had obtained information that allowed comparison between the pay line proposed by management and the U.S. market pay line as derived from the survey.

On recruitment, the Director indicated that he had just received the latest figures on the Fund's attempts to recruit economists. The rejection rate for offers was currently about 50 percent both for economists who were being recruited through the Economist Program, directly from university or with relatively little experience, and for more experienced economists whom the Fund was trying to recruit from elsewhere. Such a rejection rate was unprecedented in the history of the Fund. Of 35 offers to Economist Program candidates, seven had been rejected, and of 14 offers made to economists outside the Program, seven had been rejected.

The Assistant Director of the Administration Department recalled that Mr. Cassell had noted the Bank's proposal for a mathematical formula on the comparatio, while the Fund had a more general formulation. The Fund's approach followed the words of the JCC Report and was therefore less controversial. In addition, the staff was reluctant to set out the formula in a Board decision, precisely because of the problems that Mr. Cassell's statement had raised. That was not to say that the Bank's formula was not correct nor that it would not be useful to have a formula that could be applied with a fair degree of automaticity under normal circumstances. However, the Fund staff did feel that some degree of flexibility should remain.

The possibility that salaries in the two institutions would rise more than market salaries because of staff turnover had been raised by Mr. Cassell in his statement, the Assistant Director of the Administration Department noted. That was not, in fact, the case; the organizations in the comparator market would also have experienced a turnover of staff over any given year, with higher paid staff leaving and new entrants beginning at lower salaries. Accordingly, if the market showed that the average salary in a particular grade had increased, say, 5 percent in a year, the actual increases granted to staff members of those comparator organizations was probably about 6-6.5 percent, when one took into account the turnover of staff.

The staff representative from the Administration Department said that the Bank and Fund staffs had attempted to look into some of the differences between the two managements' proposals. The current differences between the Fund and the Bank could be fairly easily identified because the two organizations had experienced different personnel practices since 1980. The primary difference was in the salary structures; for example, the support staff salary structure in the Fund was 4 percent higher than that in the Bank, and actual support staff salaries were 3.9 percent higher in the Fund than in the Bank. The difference in the structures had come about as a result of the Bank reducing its support staff structure in the mid-1970s and maintaining extended maxima. The Bank's proposal for 60 percent spreads around the midpoints of certain grades was in order to encompass those maxima.

The other important difference between the Bank and the Fund was a result of job grading; there had been significantly more downgrading at the professional level in the Fund than in the Bank, the staff representative indicated. Almost 10 percent of the Fund's professional staff members were above the maximum salary of their grades, whereas only 1 percent of the Bank's staff members were above their maxima. That difference seriously affected average salaries by grade. In addition, the Bank's reorganization had resulted in the resignation of highly paid staff and the promotion of lower paid staff.

The Fund and Bank staff would investigate such issues as promotion rates, hiring rates, and turnover rates, in order to assess the likely developments in the two institutions in the future, the staff representative from the Administration Department concluded.

Mr. Enoch said that he welcomed the staff's comments on the comparatio since, as indicated in Mr. Cassell's statement, his chair was interested in the future implications of the various comparatios. It was his view that no specific comparatio target should be endorsed at the current stage; there should be some degree of flexibility in determining the final salary increase, which could be achieved by aiming at a comparatio range instead. That would enable the Fund to look more closely at the available information on prospects for salary increases both in the current year and in the future, and would grant the Board some discretion in its remaining discussions on staff compensation.

Mr. Grosche noted that the different proposed increases in average pay had raised a number of concerns in the Board. The JCC had been aware of the fact that the current average salaries in the two organizations differed and that the introduction of a common salary structure together with a pay policy of keeping average salaries close to the midpoints would, at the beginning, require some "catching up." They were also aware that the difference in average salaries was particularly great because of the job grading in the Fund and because of the differences in support staff structures in the two institutions.

The question had been raised whether average pay increases would continue to be higher in the Bank than in the Fund after those initial differences had been eliminated, Mr. Grosche recalled. Would such factors as growth rates, demographics, hiring and firing practices, life span of individuals, and speed of promotion allow the Bank generally to raise salaries more rapidly than the Fund? The Committee had certainly not had that in mind. When the JCC had suggested keeping average pay at the midpoints, it had intended to ensure observation of the principle of equal pay for equal work. If a higher rate of promotions and a faster turnover rate tended to keep average salaries below the midpoint in the Bank compared with the other, more mature institution, that issue should be addressed in a joint paper by both staffs. Such a paper should be written carefully; its results were not a prerequisite for reaching a sound decision on the current year's salary increase. There was clearly a gap between the average pay in the two organizations that needed to be narrowed, but he would suggest that that could be achieved in several steps. That would allow the two institutions ample time to settle the issue of a possible systemic difference in average pay increases and avoid the risk of creating new inconsistencies.

Mr. Warner made the following statement:

> As we have stated on earlier occasions, we cannot at this juncture support the managements' proposals as they stand. Our

primary concern is that to raise the whole structure by 12 percent to address recruitment concerns, as well as related issues of international competitiveness, is excessive. We are also concerned that the proposed pay line was largely arrived at by anchoring the pay line to a French/German market schedule and then attaching it to the U.S. market at approximately the level of grade B2.

What we would like to see is that the structure address first U.S. competitiveness considerations. The pay line should be based upon the U.S. pay line but could then be adjusted, by varying the midpoint progression; by tilting the slope of the U.S.-based pay line and implementing recruitment bonus systems; or by a combination of these techniques. We do not have to elevate the entire structure 12 percent. That is a significant departure, I think, from many of the concepts the JCC had in mind, although I realize that in indicating the 10-20 target range one could assume or presume that the JCC, should it have continued its decision process, might well have arrived at the same or similar conclusion. I find that a bit dangerous. I think we should adjust from the U.S. pay line in order to understand where we are competitive in that primary market; then see what margins, if any, are necessary to address international competitiveness; and then take a very focused approach on closing those gaps. We remain consistent in our view that we want to be competitive internationally, and that if there is a variance from the U.S. competitive line, then we are willing to recognize that.

We are also very concerned about the concept of extrapolating the pay line for support staff. I realize that in the view of many it achieves a lot of things, and I am not necessarily attacking the goals that it was intended to address specifically, but we would be much more secure for future purposes in understanding that the support staff pay line was established on clear market data, whatever those market data may be. If the research of the consultant and the data derived therefrom indicate that what was attempted in earlier models did not support what might be the reasonable goals of management in establishing a support staff pay line, departure from basic market principles is not fully warranted. Let us not necessarily assume that extrapolation is a panacea. Even if the market base must be determined by using higher percentiles, we would still rather see the pay line established on market principles.

Moreover, the deviation from the U.S. pay line does not seem to have been done in a systematic fashion that can be replicated easily in future years. Anchoring the line on the U.S. market at grade B2 and the French/German market at grade A9 and drawing a smooth line between them seems ad hoc. How will future Boards use such a decision in making their own choices?

We believe the Board would be well served if it could review several options relating to the pay line. Management should therefore provide some alternatives to the Board by Monday, April 17. These alternatives could vary the rate of midpoint pay progression, tilt the slope of the U.S.-based pay line, or assume implementation of a recruitment bonus system, or any combination of these. We in particular would like to see combinations that raise the average U.S. pay line by 6, 8, and 10 percent, rather than just the 12 percent proposed by management.

We are not convinced of the need for an extrapolated pay line for support staff. I do not believe internal equality is served by linking professional salaries to comparator markets, but not doing the same for support staff. Moreover, such a system cannot be defended to the outside world, particularly since managements want it to be a permanent solution.

The JCC did not make a firm recommendation on support staff salaries, in large part because of inadequate 1987 survey data. The 1988 survey data is much improved. I am sure we can devise a pay structure that takes account of quality considerations, but that is based on an appropriate market. Therefore, we would ask staff to prepare graphs displaying support staff pay lines based on the modified JCC and Washington secretarial markets at several percentile relationships. These graphs should also include the current pay line and the new one proposed by management.

Turning to the treatment of the U.S. public sector percentile relationship, statistical arguments are being put forth for the proposed change to an average plus 10 percent relationship. However, the real reason that this formula is gaining support is that, because of the heavy weight given to the Federal Reserve, when the average plus 10 percent formula is used, the proposed pay line is raised by 2 percent. Overall, the various changes to the JCC market have raised the pay line by about 3 percent--which, frankly, is not an insignificant number. Therefore, we want to stay with the 75th percentile.

There are two major points in the JCC Report that have not yet been addressed. The JCC identified several benefits that it considers excessive, including subsidized loans and termination grants, and we fully expect management to recommend their removal promptly. I would ask what management plans in that regard.

Given the complex nature of these compensation proposals and the system we are trying to establish, I believe we must address the issue of creating a standing compensation committee of the two Boards. Such a committee, acting within the carefully circumscribed terms of reference outlined by the JCC, is necessary, in our view, to ensure the appropriate implementation of the new system. It should also avoid repetition of our unfortunate experience with the current system, which led to the creation of the JCC.

Mr. Grosche said that he considered it extremely important that the steps taken to formulate the Fund's pay policy be defined as clearly as possible from the outset, thus establishing a process that could be used on the occasion of each annual salary review. He would therefore appreciate it if the staff could set out in detail all the steps involved in formulating an appropriate pay line from the time that the U.S. market data became available to the point at which the U.S. market results were tested against the French/German market. A systematic approach that made the process transparent for the current Board and for its successors was necessary.

The first step would be to construct a pay line in relation to a given percentile of the U.S. market, in accordance with the guidelines set out in paragraph 8.9(a) of the JCC Report, Mr. Grosche remarked. The next step would be to define criteria to determine the appropriateness of that pay line in terms of its competitiveness against the U.S. market at all levels. That could mean that one would bend the pay line somewhat in order to make up for a loss in competitiveness at certain levels. However, the JCC recommendations did not allow for substantial adjustment of the line. Therefore, the third step would be to adjust a pay line that was considered competitive against the U.S. market only if justified on the basis of the applicable criteria. The fourth step would then be to relate the pay line to percentile relationships to the French/German market. The fifth step would be to define the gap between the U.S. market pay line and the European pay line, at which point the Executive Board would have a clear picture of how internationally competitive the U.S.-based pay line was and could then exercise its judgment in determining the action to be taken. The Board could consider an adjustment to the U.S.-based pay line, in which case it would decide what overall percentile relationship would result in the desired adjustment. For example, the staff might construct a pay line that would result in the restoration of the 10 percent margin suggested by some Directors, but other options might also be put forward. The final step, if one did not wish to change or to improve upon the U.S.-based market pay line, would be to consider other solutions, such as a nonpensionable temporary bonus for all staff, recruitment incentives, or other possibilities.

Mr. Posthumus remarked that it was much too early to begin discussion on other measures to restore competitiveness.

Mr. Enoch said that he fully agreed with Mr. Grosche's comment on the importance of maximizing the system's transparency and with his point that some discretion on the part of the Board was necessary once that transparency had been established. In that context, he endorsed the view that an automatic margin trigger was not fully consistent with the JCC approach, which had been to use a testing range. An automatic margin trigger had a differential impact across grades, and it was at the higher grades at which little recruiting was done that one would have to bend the line in order to minimize the cost implications of using a margin. His chair was very concerned about the cost considerations of the new salary structure. Accordingly, if the establishment of a margin turned out to be an expensive way to establish competitiveness, his chair would also wish to look at more restrictive ad hoc methods, such as those proposed by Mr. Grosche. That was not inconsistent with the current practice of granting expatriates such benefits as home leave and education allowances. Nevertheless, the total costs of expatriates to the Fund remained lower than that of employing U.S. citizens. Accordingly, the most cost effective way seemed to be to direct incentives more particularly at expatriates.

Mr. Grosche clarified that the first step, in his view, should be to derive a pay line that was competitive in the United States for all U.S. staff. Only after having reached competitiveness in the main comparator market should the resulting pay line be compared to the international market. If that were done, the problem of international competitiveness might be less severe than it currently seemed.

Mr. Warner said that he strongly supported Mr. Grosche's remarks. It was much more transparent to establish a pay line that was competitive in the U.S. market, and then make the necessary changes to ensure international competitiveness. Certainly, the foreign exchange factor was an important element in that relationship. He also welcomed Directors' receptiveness toward special tools to address the international competitiveness question. He was offering management some flexibility in deciding which combination of those tools would work most beneficially. Notwithstanding the fact that the general discussion of benefits came much later in the year, it should not be forgotten that if some of those special tools were adopted, that would have an impact on the global benefit package. It would be useful if the staff could provide the Board with graphs on the impact of the management proposals on support staff salaries. Adjustment of the professional pay line would lead to a significant gap between the extrapolated support staff pay line and that based on market data.

Mr. McCormack asked whether Mr. Grosche, in referring to the use of tools to achieve international competitiveness, was expressing his first preference, or simply an alternative to be considered if competitiveness could not be reached on the basis of the JCC recommendations.

Mr. Grosche said that the JCC had not been able to formulate a clear-cut view on the precise measures to take if the 10-20 percent margin of international competitiveness was eroded in either direction. Both managements had expressed distaste for remedial actions that would create divisiveness within the staff, and considered it preferable to simply adjust the whole pay line. While he had sympathy for that approach, it had not been the unanimous view of the JCC. Some members had been strongly in favor of introducing an expatriation allowance. However, the divisive effect of that on the U.S. staff could be counterproductive. Similarly, recruitment premiums could also lead to problems in internal relativities. Another option would be to add housing allowances to the expatriate benefits in order to compensate for the steeply rising housing costs in the area. Many potential recruits considered that although the Fund's salaries might be competitive on an absolute basis, they were eroded when one judged them in terms of purchasing power in the Washington area. That was particularly relevant if the recruit's spouse was not able to pursue a career that had been established in the home country. The easiest solution might well be to adjust the U.S. market-based pay line.

The Assistant Director of the Administration Department said that if expatriate allowances were adopted to ensure international competitiveness, that allowance would not, as Mr. Warner suggested, form part of the overall package of benefits that would be reviewed at the end of the year. The Fund had never included expatriate benefits in the package of benefits used to compare Fund compensation to the market, since they were designed to compensate for problems experienced by a specific group of the Fund staff.

Mr. Ovi said that he did not consider that any adjustment in staff compensation should be taken into account when discussing the benefit package; they were two very different issues that should be discussed independently.

Mrs. Filardo asked whether Mr. Grosche agreed with management's proposal or favored the JCC recommendations.

Mr. Grosche said that the JCC had begun with the 75th percentile relationship to the U.S. market and found that that relationship was almost equivalent to the outcome of the average plus 10 percent formula. The JCC recommendations suggested that the 75th percentile be a starting position from which one could begin to assess competitiveness with due regard to costs. One then had to decide whether that percentile relationship was sufficient to meet the Fund's needs. Once a percentile relationship had been selected, it ought to be adhered to as much as possible so that the salary structure would move in accordance with the U.S. market.

The Assistant Director of the Administration Department said that the staff had, in its paper, expressed considerable doubt about the competitiveness of the 75th percentile relationship to the U.S. market. The JCC recommendations suggested that there were a number of ways of determining competitiveness. For example, the staff considered that competitiveness in all markets meant that the Fund had to be competitive against the U.S. private sector market, which was the reason behind one of its earlier suggestions that there be a floor against the U.S. private market below which the Fund pay line would not be allowed to fall. While that proposal had not been taken up by Directors, it should perhaps be taken into account, particularly since the earlier debates on staff compensation had been based on the expectation that the U.S. public sector would soon be experiencing a large pay increase.

Mr. Ovi cautioned that there were dangers in moving toward a transparent system. While it was reasonable to discuss the philosophy behind a system, at the same time one could not disregard the likely impact of the system in the present circumstances. The steps outlined by Mr. Grosche could run the risk of replacing the problems of international competitiveness with problems concerning the competitiveness of the U.S. pay line. He therefore welcomed Mr. Grosche's point that it was essential that U.S. competitiveness be firmly established in the initial round, at which time a reasonable percentile could be selected and adhered to. It seemed that Mr. Warner shared that understanding.

He recalled that Mr. Grosche had said that judgment should be exercised on the international competitiveness of the U.S.-based pay line, Mr. Ovi continued. He, however, agreed, with Mr. Posthumus that it was too early to discuss the use of tools to adjust international competitiveness.

Mr. Warner said that it was true that his views were close to those of Mr. Grosche, in principle. Both he and Mr. Grosche had attempted to base their views on the JCC recommendations and the staff report, while taking into consideration time limits and the constraints of the real world. He agreed with Mr. Grosche that expatriate allowances in general, and specifically housing allowances, would present a complicated political question. However, recruitment premiums could remain a tool to be used if the pay line was not in fact competitive in the U.S. market.

Regarding benefits, his allusion to the discussion later in the year on the global benefit package was not meant to confuse that issue with the question of international competitiveness, Mr. Warner stressed. His observation had been that the current discussion had to take into account the cost to the institution. Accordingly, any changes to the compensation system had to be made with an understanding of the impact on the global benefit package.

Mr. Ovi said that there was a clear difference between the views expressed by Mr. Warner to date and the suggestion by Mr. Grosche that there be a well-defined rule for establishing competitiveness with the U.S. market.

Mr. Warner said that all his remarks had taken into account the flexibility and judgment that had to be left to the Board when determining international competitiveness. However, as Mr. Grosche had said, once it had been established how to achieve U.S. competitiveness, that approach ought to be automatic. Certainly, there was a case for reviews, but a system ought to be set and adhered to for at least several years. A standing joint committee could review the issue annually and give specific advice to the Board as to when additional reviews might prove necessary.

Mr. Al-Assaf remarked that if the housing and expatriate allowances might be politically unacceptable, an alternative way to address the international competitiveness issue would be for the U.S. authorities to ease restrictions on the employment of staff members' spouses and dependents in the United States.

Mr. Filosa noted that Mr. Grosche had clarified the ways that judgment ought to be made on different elements of the pay line. Certainly, there was a need for transparency of the system, and he accepted the fact that the pay line might have to be bent in order to achieve competitiveness. However, the staff's response had given him the impression that a U.S.-based pay line was not internationally competitive, according to the market data. If that was the case, the U.S.-based pay line did have to be revised.

The JCC had spent four years discussing the new compensation system, and the procedure proposed by Mr. Grosche ought to be implemented promptly, Mr. Filosa emphasized. However, he would remind Directors of the data on rejections of job offers by potential recruits. If non-U.S. citizens were to be attracted to work at the Fund, any adjustments to the pay structure had to be permanent. An expatriate allowance was not an effective tool if it was a once and for all payment. A further advantage of raising the pay line as opposed to using specific tools was that of simplicity. The evidence in the staff paper firmly supported adoption of the proposed pay line.

On the issue of the comparatio, Mr. Filosa said that he agreed with the principle of equal pay for equal work. However, if the wage structures in the Fund and the Bank differed for demographic reasons, the comparatio should not be applied blindly, without taking into account that difference. For example, each institution should be free to decide on the way in which merit increases were distributed. Accordingly, the establishment of a single comparatio for both institutions did not seem appropriate. There were other solutions, such as dividing each grade into equally spaced benchmarks, and then having the two institutions reach a comparatio of 100 around each of those points rather than only at the midpoint. He would welcome the staff paper on the reasons behind the different average wages in the two institutions and the differences in their distribution in each grade.

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

LEO VAN HOUTVEN
Secretary